

WESSEX WATER SERVICES LTD

Annual Report and Financial Statements 30 June 2018

Registered in England and Wales No. 2366648

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STRATEGIC REPORT

Principle Activity

The principle activity of Wessex Water Services Ltd (WWSL) is as a regulated company licenced for the supply of clean water and treatment and disposal of waste water. WWSL operates in a region of 10,000 square kilometres in the south west of England. From 1 April 2017 there was a change in the regulated activity of WWSL with the retail element of non-household companies being open to competition. To enter into that competitive market the parent company of WWSL, Wessex Water Ltd set up with Bristol Water Holdings Ltd a new company, Water 2 Business Ltd.

Introduction

At Wessex Water, we are proud of our record in delivering essential water and environmental services.

We retain a strong sense of public service across our organisation, which is run by local employees who are customers themselves and members of the communities we serve.

I am pleased, therefore, that we have had another strong year, exceeding most of our targets and improving our service. The investment and performance that we have delivered in the past 12 months, reported here, demonstrate that we take our responsibilities seriously.

Customers and communities

We continuously ask our customers what they like about what we do and where we can improve. We work hard to deliver what they want – a reliable service that is value-for-money and provided without fuss.

This year we have been consulting widely on our plans for the future. Our multi-channel Your Say Your Future programme has enabled nearly 80,000 customers to make their voices heard and I encourage all our customers to let us know their thoughts.

We consistently achieve satisfaction ratings above 90% and currently 96% of our customers rate our service as very good or good.

It is important to us that we are able to support all our customers, including those in vulnerable circumstances.

Our partnerships with the debt advice community are thriving and we continue to believe that holistic advice is vital to help customers get back on track and into sustainable payment. Water is an essential resource that should never be limited by ability to pay.

Our teams have launched dozens of new projects and partnerships across our region, including with the Quartet Community Foundation, leading to a 37% increase in the number of people on low incomes who are receiving assistance from us to pay their bills or manage their debt.

More than 500 staff have also completed the Alzheimer Society's training to understand what it's like to live with dementia and how to turn that understanding into action.

This year we launched our new staff volunteering programme, Wessex Water Force. Staff can use one working day a year for volunteering, equalling around 18,750 hours of support donated every year to charity. This is just one strand of our vibrant communities' programme covering community support, health and wellbeing, leisure access and community education.

Resilience

Our services need to be able to withstand whatever the future throws at them, whether that be more extreme weather events, cyber attacks, or unexpected asset failures.

The freezing conditions and heavy snowfall in early March were some of the most serious weather events to hit the water industry for many years. The combination of rapid freezing and thawing led to many of our customers suffering burst pipes in their properties, causing a substantial increase in water demand. However, our investment in resilience proved its worth as not a single customer in our region lost supply.

A significant contribution to this was the completion during the past year of our regional water supply grid. This £228m seven-year programme of works now enables us to move water across our entire region, greatly increasing the resilience of supplies.

It has enabled us to deal with deteriorating raw water quality, particularly rising nitrates, by allowing us to blend water, and to reduce abstraction in areas of our region where this was reducing the water flow in sensitive rivers, thus improving the environment.

Our people

Our team at Wessex Water are incredible. They consistently go the extra mile to help customers and improve the environment and it takes a huge team effort to stay at the leading edge of the industry.

As a customer, it is easy to take water and sewerage for granted because it so rarely causes us any problems. That is only possible thanks to the tireless work of our great people, 24 hours a day, 365 days a year. I thank them for their continued support and commitment.

Our People Programme is in full swing and has already started delivering initiatives to improve the way we look after our people, enhance our diversity and ensure we have a pipeline of talent flowing through the business to

STRATEGIC REPORT (continued)

create the leaders of tomorrow. One of our proudest achievements this year is that apprentices and graduates on formal training now represent around nine per cent of our total workforce.

We have launched a range of wellbeing initiatives over the year covering areas such as financial education, building personal resilience and mental health awareness.

Financing and investment

Last year saw £250m of investment in maintaining and improving our assets and the services that they underpin. Our profit after tax fell £35m to £116m (excluding exceptional items), largely because of increased tax charges. We also saw a drop of £17m in profit before tax before exceptional items caused partly by an increase in financing expense of £10m and a fall in operating profit of £6m.

Under YTL's stewardship we have always been structured and financed in a simple and transparent way that ensures we are financially resilient. Our gearing will continue at under 70% and we will continue to maintain a straightforward corporate structure. We are classed by HMRC as low risk.

The future

In September 2018 we submitted our business plan for the period 2020 to 2025. Our ambition runs through the plan and shows that we view water as a natural resource in which everyone has a stake. It shows how we share value with our communities who, in turn, assist us to meet better outcomes. And it shows that we are transparent, accountable and financially resilient.

It is a plan that sets out our vision, defines the challenges that stand in the way, and describes how we will go about making bills affordable for every household and build an exceptional service based on our customers' convenience, not ours.

Customers and communities

We put customers at the heart of everything we do and our customer service vision remains very simple. We aim to deliver the highest levels of customer satisfaction, make it easy for customers to deal with us and ultimately build trust and loyalty.

We achieve this by delivering what customers say is really important to them:

- excellent and reliable water and sewerage services at a price they can afford
- a service tailored to meet their individual needs
- choice and flexibility in the way they can communicate and interact with us
- a real person to answer the telephone
- resolving problems quickly and first time
- keeping them informed at all times using their channel of choice
- checking they are happy with the outcome if they have a problem
- compensating without quibble if things go wrong.

We encourage staff to go the extra mile whenever they can and invite customers to let us know if we have done well or need to improve.

We remain one of the most consistent top performers in the water sector for customer service. This is the third year of Ofwat's new look service incentive mechanism (SIM) and although we have come a close second of all water and sewerage companies in the satisfaction survey element this year, we hope to retain our top spot again on the overall SIM through our excellent performance on complaints.

We do not simply want to be the best for customer service in the water sector; we want customers to value our service as highly as the service they receive from top household names.

We know there are challenges ahead:

- customer expectations continue to rise, and they increasingly demand a more personalised and effortless service
- our future customers, the youth of today, will want a very different and increasingly digital customer service experience
- some areas of vulnerability are becoming more prevalent in society, such as mental health, and our staff need to be properly equipped to support our customers
- as we are very reliable, we are a silent provider to many, so we need to build stronger relationships with our communities.

We are rising to these challenges through delivering our customer excellence programme, shortly entering its third year, and are also benefiting from our membership of the Institute of Customer Service.

STRATEGIC REPORT (continued)

We have reviewed and co-created our strategy for supporting customers in vulnerable circumstances with our customers and stakeholders and agreed areas on which to focus to raise awareness and increase take up of our affordability support (tap) and Priority Services.

Through our innovative, multi-channel “Your Say Your Future” engagement programme, all our customers have had the opportunity to influence the level of bills they pay and the service they receive in the future.

This year we have come a very close second among all water and sewerage companies in the satisfaction survey element of the SIM, and we hope to retain our top spot overall due to our excellent record of performance on complaints.

Through our desire to go the extra mile and deliver excellent service, we were one of the only companies to keep water flowing for all customers throughout the extreme “Beast from the east” winter weather.

Our own feedback surveys show that customers continue to score us highly on satisfaction, first-time resolution, staff conduct, and knowledge and effort.

This year we have made improvements to our continuous improvement programme that uses this feedback, alongside ideas from staff, to deliver change for customers at a faster pace.

We have made full use of our dynamic customer journey mapping tool to look at journeys through the eyes of the customer and identify improvements that would make the most difference to them. This includes the customer journeys associated with many of our Priority Services customers.

In terms of our performance commitments, 96% of our customers rate our service as very good or good.

Our value for money score has dipped, with 70% of customers rating our service as very good or good value for money. While this is still a strong score, it is lower than we have achieved recently.

There have been no significant changes in our bills, people’s average income or the country’s overall financial situation, so we will redouble our efforts to ensure we engage our customers more than 90% of whom have told us our plans for 2020-2025 were acceptable and affordable.

On customer effort, our surveys show that 93% of customers say it takes little or no effort to resolve their query. We are required to consider an update to the source of this data this year and our customer challenge group has approved a move to a new methodology.

Compared with sectors outside water, our net promoter score compares favourably with many of the top UK household names. Our UK customer satisfaction index score shows we are towards the top of the utility sector and not far away from the top 50 companies across all sectors.

In September, the Consumer Council for Water confirmed that we continue to have the lowest number of complaints in the water industry with no investigations. Supported by our new Every Word Matters writing style, both billing and operational teams have continued to focus on reducing complaints and unwanted contacts. We’ve seen a reduction in escalated complaints and are resolving 95% of our complaints first time.

Day to day we continue to offer a full range of communication channels while remaining committed to offering personal telephone answering and, most importantly, choice for our customers. We continue to see a growing number of customers opting for self service, text messaging and web chat. Satisfaction on these channels remains high.

Keeping customers informed when we have problems on our network, such as a burst water main or when we are fixing a problem at their own home or business, remains one of our key drivers of satisfaction.

Proactive phone calls or text messages from our dedicated customer care team have proved an effective way to let customers know what the problem is, what we’re doing to resolve it and by when. The team oversees the whole customer journey, keeps it on track and can provide additional support to customers in vulnerable circumstances.

We continue to make wider use of proactive bulk text messaging and social media posting during operational problems such as burst water mains. A full review of our signage is taking place over the next year, including options for digital signage.

As part of our efforts to build a detailed picture of what is happening on jobs and to shorten our diagnosis and repair times, we’re extending the opportunities for customers to send photographs while operational work is in progress, and trialling the use of 360-degree cameras during site inspections.

Our focus on giving staff the right tools to do their jobs has extended into other areas of our business. The Every Word Matters training on a more simple and conversational style of writing has reached our teams in developer services and insurance. We have also rolled it out to our contact centre agents and into the web chat knowledge base.

We retained our government backed Customer Service Excellence award for our approach to customer service and have the best overall package of customer guarantees in the industry. We continue to hold the best practice mark of distinction from the Keep Me Posted campaign.

STRATEGIC REPORT (continued)

Our operational contact centre holds the Institute of Customer Service's ServiceMark with distinction, one of only 10 in the UK to achieve this accolade. We plan to widen ServiceMark accreditation to other customer facing departments over the next two years, starting with our repair and maintenance teams.

We are about to enter the third year of our customer excellence programme and over the past year we've focused on:

- implementing our new contact management system
- launching a new digital job tracker to allow customers to track progress towards resolution of their contact online, similar to the delivery of a parcel
- launching our Every Word Matters training programme on communication style
- extending our real-time feedback dashboards across customer facing teams
- improving our self service offering.

We have also relaunched our e-billing service, giving customers a convenient online billing experience. The technology we've used will also allow us to grow this service over the next 12 months and deliver effortless online experiences. This year we have been through a full redesign of our bills. Metered bills will contain improved graphs of water use, enabling customers to not only compare their own water use over time and identify possible leaks, but also to compare it with similar sized households.

Customer engagement

We engage extensively with our customers and stakeholders, both in our day to day business and for specific programmes of work, such as preparation of our five-yearly business plan.

Our challenge group, the Wessex Water Partnership, oversees all our engagement and how it is used. The full partnership has met 11 times since its inception and is independently chaired by Dan Rogerson, formerly water minister in the coalition government.

Our innovative and multi-channel engagement strategy – Your Say, Your Future – continues. This year we've conducted major pieces of research to obtain customers' views on the balance between service and price, bill profiles and their opinions on the future proofing of our services, leakage, our offering for customers in vulnerable circumstances, as well as the acceptability of our draft Business Plan for 2020-2025. Our new innovative business plan game went live in late October 2017 and was an integral part of this engagement, along with our community roadshows.

Our successful Young People's Panel of sixth formers recruited from schools and colleges across our region has just completed its second year. Last year's panel helped us design our new cash back guarantee for meter options and our digital job tracker, and this year the 23 students helped us design ways of encouraging younger people to care about the waste system to build resilience for future generations. They came up with some excellent campaign ideas for sewer misuse and these will be taken forward.

Our Have your say online customer panel continues and this year we sought its views on:

- amenity value of our reservoirs
- attitudes to water use.

The panel will also take part in the testing of our business plan.

We follow up each survey with a newsletter to participants explaining the findings and what we are doing as a result.

Customers in vulnerable circumstances

Anyone can find themselves vulnerable at any time due to illness, unemployment or simply a change in circumstances such as a bereavement or relationship break-up. Because our customers are our priority, we are committed to providing extra support and help when and where it is most needed. We pride ourselves on treating customers as individuals and tailoring our service to suit their needs, making sure we are inclusive and accessible to all.

Our approach to customer care, coupled with the support schemes we offer customers in financial difficulty or who have specific additional needs, has enabled us to retain the British Standard for Inclusive Services for another year, one of our performance commitments, and the Louder than Words charter mark.

Our new look vulnerability strategy has been co-created with stakeholders and customers. So far 23 organisations have endorsed our service for those in vulnerable circumstances.

We have made sure staff have the right skills, confidence and awareness to deal with often quite complex situations, and strengthened this with specialist training. To complement the face to face training on mental health developed with Wiltshire Mind, we have launched an e-learning programme for all staff to help them spot the signs of mental ill health and support customers, colleagues, friends and family. We have also held training sessions with the Samaritans and Alzheimer's Society.

We have committed to being a dementia friendly utility. We were an active member of the British Gas task force aimed at encouraging utilities to become dementia friendly and feature in the recently launched Dementia

STRATEGIC REPORT (continued)

Friendly Utilities Guide. Around 550 of our employees are already Dementia Friends, the remainder are due to be trained by the end of 2018. We will also make sure our sites and signage are dementia friendly.

We hold a Priority Services register of customers with longer term disabilities or additional needs and, as they are likely to need the same support from their energy provider, we are doing all we can to signpost customers to other utilities. The number of people on the Priority Services register has increased 30% this year.

We have embarked on several pilot projects to share data with energy companies. This will ensure customers only need to register once for Priority Services across all utilities. We are playing an active part in the wider work to introduce data sharing at a national level by 2020.

One of our key outcomes is to ensure bills are affordable for all. We remain committed to tackling this issue and growing the support we offer customers who are financially vulnerable through our tap programme. Tap offers customers tailored solutions to their affordability problems via a range of schemes and low rate tariffs to help them afford their ongoing charges and repay their debts, along with practical help to reduce their water and energy use.

We provide this support through long standing and very effective partnerships with the debt advice sector, either face to face, telephone or online providers. Under the guidance of our expert affordability advisory group, we are helping more than 37,000 customers through tap, a 37% increase over the year.

Around 11,500 customers receive our main social tariff, Assist, which offers discounts of up to 90% off water charges for those in the greatest financial hardship. Just over 13,000 pensioners on Pension Credit are receiving a discount of around 20% on their bills.

Our partnerships with the debt advice community are thriving and we continue to believe that holistic advice is vital to help customers get back on track and into sustainable payment – it's never just about water debt. We are also liaising with a growing number of community based organisations outside the debt advice sector and using geographical mapping to help us engage with customers who are traditionally much harder to reach and likely to be some of the most vulnerable.

We have also launched seven new projects in hard to reach areas such as deprived housing estates. We recently partnered with the Quartet Community Foundation to deliver our Money Matters awards, which are now in their fifth year. Since Money Matters began, we have provided grants to 33 different organisations delivering financial capability and money management projects across our region.

This year we have launched our new online partner hub, designed to make engagement with us even easier. The hub will allow our partners to obtain information on the support we offer, request resources and application forms, apply for schemes on behalf of their clients, advertise and request our attendance at community events and network with one another online.

Community and education

Keeping customers of all ages informed about what we do and helping them to conserve water and prevent blockages in our sewers forms an important element of our day to day work.

Twenty years ago, we started our free education service to schools and in addition, we introduced education centres at some of our sites around our region. The team delivered topics ranging from water conservation to what happens to waste once it has been flushed down the toilet. Last year 22,022 students benefited from school visits and trips to water and sewage treatment works. Our three education advisers cover Bristol, Bath, Somerset, Wiltshire, South Gloucestershire and Dorset.

We also engaged further with customers by attending events around the region such as the Yeovilton Air Day and the Great Dorset Steam Fair in Blandford. We launched our Make Every Drop Matter campaign to highlight the importance of looking after what flows from the tap. In addition, Our Stop the Block campaign highlighted what should not be put down the toilet and provided an opportunity for customers to find out about what we do and ask questions.

Our website and publications offered educational information to customers including encouraging use of our online water and energy calculator and providing informative online videos.

The Wessex Watermark environmental grant scheme has been supporting environmental projects across our region for nearly 25 years. Schools, parish councils, youth groups and community organisations can apply for financial assistance of up to £1,500. Last year we supported the Saltford Brass Mill project with a grant of £300 and gave £500 to the Stoke St Gregory Allotments

Association to help set up a reliable water source for the allotments, and many other projects.

The new Water Force employee volunteer programme is now under way with the first staff groups taking part in activities in the community.

As the programme develops it will enable more skills based volunteering and, working with the social policy unit, we hope to arrange Dementia Friends volunteering to complement the Dementia Friendly commitment already in place.

To date around 200 staff have donated volunteer time for a range of environmental and social activities with beach cleans, tree planting, animal rescue centre and older people's charities all supported.

STRATEGIC REPORT (continued)

We piloted a project in the Chippenham area which has progressed well and enabled us to trial a new approach for engaging with a local community for positive reasons rather than simply in response to works or identified issues

An initial workshop took place to involve local staff and gain an overview of the local area, including local priorities, issues, events and ideas for future engagement. This was repeated with invited community partners to generate local engagement and support for our activities.

Ideas arising from this engagement include more local support and promotion of the Home Check service, feedback on the position of a community refill point and support for a Yellow Fish river drain awareness project to support the local environment.

Meetings and presentations have also taken place at the town council and local area board. Information from initial work at Queens Crescent offered the opportunity for the first use of a pilot 'community identity' as part of the support for the local school.

Market opening

The new retail market enabling business customers to choose their retailer for water services celebrated its first birthday this year. There are now 41 retailers active in the market and 26 of these are national retailers.

The water industry has concentrated on ensuring stability in the first 12 months of market opening, focusing on processes, data improvements and the standards on which retailers and wholesalers are measured.

Our wholesale services team has supported the national efforts by focusing on delivering high standards of customer service, joining numerous working groups and completing continuous improvement cycles to enable rapid change for retailers and customers. We also launched our accredited entities scheme, giving retailers more choice on who carries out metering and disconnection work.

We continue to work with the market operator, Ofwat and Defra on ensuring the market is a success for all participants, particularly its 1.2 million customers.

Highest quality drinking water

We are committed to providing the highest quality drinking water to our customers. Our overall compliance with drinking water standards in 2017 was 99.96%, which was an improvement from 2016.

There was a total of eight failures out of approximately 25,000 tests, of which five were due to customers' domestic plumbing and service pipes. The other three failures were related to a single incident at a property related to an iron water main. These eight water quality failures were down from 23 in 2017.

There was further reduction in the number of customer contacts about acceptability of water – customers have seen the benefits of our ongoing mains rehabilitation work and improved customer communications.

Sewage flooding minimised

Sewage flooding is thankfully a very rare occurrence but when it does happen it can be devastating – so tackling it remains one of our key objectives.

The number of flooding incidents caused by blockages in public sewers fell further last year, down to 1.21 incidents per 10,000 properties compared to our target of 1.70.

This was the result of:

- our campaigns about the problems caused by flushing wet wipes down toilets and pouring fat down sinks
- optimising operational maintenance
- the generally dry weather conditions in the region last year.

We continue to work closely with the national 21st Century Drainage Programme to try to bring about change in what customers flush into the sewers because this factor has the biggest impact on flooding and pollution levels.

In 2015, we introduced a new and innovative measure of overall flood risk due to inadequate capacity of our sewers during heavy rainfall. Last year we invested £9m to reduce this risk at 87 locations and have met our target. A large project at Brent Knoll was delivered in 2017-18, which reduced the risk of flooding to 46 locations.

The responsibility for flooding is complex and we work closely with other flood risk management authorities – we were consulted more than ever before, attending more than 120 liaison meetings. We contributed over £100k towards the partnership schemes to reduce flood risk, including £50k towards a scheme in Wrington, Somerset.

A new framework is being developed for all water companies to give visibility of long-term sewerage plans. It is an ambitious framework which we are embracing, requiring drainage and sewerage management plans to be published by 2023.

Several locations in our region with water bearing chalk strata can be affected by high groundwater levels which infiltrate the sewer network and restrict toilet use. It is a complicated issue so to help customers understand it

STRATEGIC REPORT (continued)

and help prevent it, we produced a computer-generated animation explaining ‘How groundwater can cause sewer flooding’.

Our infiltration reduction plans continue to reduce the risk of groundwater entering sewers and drains. We proactively inspected more than 100 km of sewers for signs of infiltration and permanently sealed 6.1 km of sewers where seepage was occurring.

Resilient services

Our asset management system continues to help us deliver our strategic business objectives through an integrated approach to risk and investment decision making, effective asset lifecycle management and by driving continuous improvement.

Following an annual surveillance audit our asset management processes were again certified to the international standard for asset management (ISO55001:2014).

During the year we carried out an assessment of the resilience of our business, assets and services. Our methodology assesses the status of our systems and processes and identifies improvements; it also provides a consistent framework to manage progress. We will be using external auditors to review our resilience in line with the British Standard for Organisational Resilience (BS65000:2014).

Our north Bristol sewer scheme will improve sewerage systems in both the Frome and Trym catchments, in both cases diverting sewage flows away from Bristol city centre. We have made great progress with both these projects and the Frome scheme will be delivered ahead of time by August 2018 and in use by the end of 2018. The Trym scheme is also on track and work began on design, consultation and construction last year.

In 2010, we started work on our biggest ever project, a major integrated water supply grid enabling us to:

- reduce abstractions from sensitive groundwater sources
- move water more effectively around our region
- ensure future demand is met
- improve the resilience of supplies to customers.

The final parts of this project have now been completed and the whole system is in full operation. This year we have reduced the number of properties supplied by a single source by a further 6,000, and achieved our final target one year early.

In 2017-18 we achieved a supply interruptions figure of 12.3 minutes, an improvement on our past performance but not quite sufficient to meet the tightened target, resulting in an underperformance payment. Despite this, we have made considerable improvements which gives confidence we will meet the target for the rest of the period.

In March, the water supply grid proved how much additional resilience it has created. It enabled us to continue to provide water to all properties in our region even after the rapid thaw event which saw so many supplies interrupted elsewhere in the country.

Environment

Our region contains many of the country’s best rivers and streams and we are focused on working with other stakeholders in continuing to protect and improve their condition.

By cutting leakage and managing customer demand and working with communities where there is concern about local effects of abstraction, we have reduced the amount of water we take from the environment.

Our region is rich in wildlife with many areas protected by international and national designations. We take our duties towards the environment seriously and are actively reviewing our landholding and combining this information with our geographical information system to develop land management plans to improve

All projects in our capital investment programme are subject to detailed environmental screening to avoid harming wildlife. We also offer grants to wildlife organisations under our biodiversity action plan Partners’ Programme, which is helping to further our catchment management objectives.

Collaboration and innovation underpin our significant early progress against our challenging environmental outcomes. This has resulted in our industry leading performance.

Improved bathing waters

This year 96% of our bathing waters passed strict environmental standards. However, two (Uphill Slipway and Burnham Jetty) were assessed as having below standard water quality, which is below our 100% target. We completed the National Environmental Programme schemes in the year, achieving 100% performance against target to deliver agreed schemes.

STRATEGIC REPORT (continued)

Schemes to improve our assets that may affect the Burnham Jetty bathing water include:

- constructing a 3,000m³ underground storage tank and a new pumping station at Bristol Road, Bridgwater
- proactively investigating misconnections of foul flows that could end up in the River Parrett in Bridgwater
- providing 150m³ storage at a new pumping station to transfer flow from Combwich to Cannington
- installing UV disinfection plant to disinfect flows from Combwich and Cannington.

We are supporting Litter Free Coast and Sea project officers in both Dorset and Somerset to develop and deliver innovative engagement and awareness campaigns to raise awareness and ownership of bathing water quality, and to promote behaviour change campaigns for residents, tourists and businesses.

Rivers, lakes and estuaries protected

Our programme for 2015 to 2020 includes the reduction of phosphorus concentration in discharges at 47 water recycling centres (WRC) and improvements to the ammonia discharges at eight WRCs. Phosphorus is a nutrient that can contribute to excessive weed growth whereas ammonia, at high concentrations, can be toxic to animal life. During the year, we have completed improvements at four WRCs for further phosphorus removal and six WRCs for reductions in ammonia.

The National Environment Programme also included a series of technology trials designed to test the performance of new processes to meet future, more stringent targets for phosphorus levels in sewage discharges required by the EU Water Framework Directive. These were completed last year and we have used the results to assist us in the next investment period 2020-25 where we are planning for a further 64 potential phosphorus improvement schemes.

Catchment and community based strategies

The resilience of our customer services is closely tied to the resilience of the wider water catchments in which we operate.

We use catchment-based strategies to protect our service levels; often this means we can deal with the source of the problems not the symptoms. We are currently working with farmers at 20 sites to reduce nitrate levels in groundwater sources or to remove pesticide risks from reservoirs.

We are now taking catchment-based approaches to reducing nitrate run-off into Poole Harbour rather than installing nitrate removal at a water recycling centre and finding innovative ways to maximise the benefits achieved at the lowest cost to customers.

We actively support customers to take part in water saving – in the past year we have undertaken more than 10,000 Home Check visits to fit water saving devices and offer bespoke behavioural advice. Savings average more than 40 litres per household per day and the scheme is proving very popular with customers.

We linked this programme to our abstraction incentive mechanism site in Mere this year to encourage the uptake of water saving in a community where there is a particular concern about abstraction.

In December 2017 we launched our new Money Back guarantee scheme to encourage the uptake of optional metering by customers.

We have also designed a 'water citizenship' project that will shortly begin in Chippenham where we will work with the local community to enhance their relationship with their local water environment. The project will help us tackle multiple issues including water saving, sewer misuse and wet wipes/FOGs, and hydration and water refill.

Tackling leakage and improving water efficiency

We are committed to reducing the amount of treated water that is used unnecessarily or lost through leaks from our pipework. This maintains the resilience of our services, helps to keep bills affordable and leaves more water in the environment.

During 2017-18 we reduced leakage to below 68 Ml/d which meets our target for the year, despite the short-term increase in leakage during the adverse weather in March. We also met our target of fixing 70% of leaks reported to us in the same day.

We expanded our Home Check water efficiency programme and made more than 10,000 visits to customer properties to fit water saving devices, fix simple plumbing leaks and offer tailored behavioural advice. We repaired nearly 4,300 of our customers' leaking pipes free of charge to help reduce their water use.

While we met our target for water saved through water efficiency promotion, average daily water use has increased to 143 litres per person, which is above our target. Per capita consumption is influenced by many variables which are outside our control, not least the weather conditions – we attribute the rise in consumption this year in part to the particularly dry spring and autumn.

STRATEGIC REPORT (continued)

With the completion of our water supply grid in 2018 we will be operating well below the economic leakage level meaning that, without new ways of working, the cost of reducing leakage further will outweigh the value of the water saved. We will continue to innovate as we seek to meet our target of 5 MI/day by 2020.

Water resources

Rainfall last year varied – a wetter than average summer was followed by a particularly dry autumn which delayed the start of reservoir and groundwater refill. However, the year ended with a very wet March, taking rainfall over the full year to 101% of average. The improvement in resource availability arising from the wet March put us in a good position for starting 2018-19.

We successfully met our performance commitment regarding the abstraction incentive mechanism at Mere in 2017-18. During the time the groundwater level was below the trigger level we exported only 30 MI of water from the local catchment against a target maximum level of 100 MI.

Last year was the 42nd since we imposed any customer restrictions on water use, such as hosepipe bans.

In November we submitted a new draft water resources management plan to Defra which set out how we will maintain a balance between supply and demand while protecting the environment for the next 25 years.

We forecast a surplus for the full planning period and set out ambitious proposals to extend our water efficiency work with customers, pursue greater levels of metering and continue to deliver leakage reductions.

Environmental investigations

Our environmental investigations programme enables us to better understand our regional environment and the impacts our activities have. This means that we can base any future investment decisions on sound data and evidence, giving us confidence that issues will be addressed at the best value to our customers. As part of this programme we trial innovative and alternative solutions, aiming to deliver multiple environmental benefits from our actions.

In AMP6, we are delivering 45 environmental investigations covering a range of issues from:

- the occurrence and removal of hazardous and emerging substances from sewage effluent
- the effectiveness of green and social prescribing to reduce pharmaceutical concentrations in sewage
- trialling new, sustainable treatment solutions for phosphorus and chemical removal
- understanding the ecological impact of our reservoirs and abstractions
- understanding the impact of our sewage treatment works on the nutrient levels within rivers, compared to other sources, at a catchment scale
- trialling techniques to restore and enhance the grassland and woodland habitats to improve connectivity for species to disperse across the local landscape.

Many of our investigations are ending because data must be collected for our next business plan. Several of the investigations have been industry firsts, testing new ways of working or different technologies. A summary of the findings is available on our website: wessexwater.co.uk/About-us/Environment/Environmental-investigations.

Our Bristol Avon catchment permitting trial, a UK first, took a catchment approach to limit phosphorus discharges from our assets and manages the discharges from 66 sewage treatment works/water recycling centres in combination, rather than individually.

During 2017, we have removed 37 tonnes of phosphorus, against a target of 25 tonnes. By optimising our existing assets, and only constructing new phosphorus removal treatment where it can be demonstrated to have a quantifiable benefit to the river, we are delivering the same phosphorus reduction at a cost to customers £24m lower than a traditional single site based approach.

Our public health project is working with B&NES Council public health department, the University of Bath and delivery providers such as Avon Wildlife Trust, Bath City Farm, Developing Health Independence and Timebank. We are trialling an approach with a local NHS doctor's practice to prescribe green or social interventions, rather than pharmaceuticals to certain 'at risk' patients, with the aim of reducing the amount of chemicals reaching our sewers.

Through chemical analysis of the sewage, we are testing whether these interventions achieve reductions in the levels of certain pharmaceuticals in sewage. This is another industry first and will help to inform the proposed government chemicals strategy.

STRATEGIC REPORT (continued)

The outcome of all our investigations is being fed into our next business plan, to deliver the most cost effective and sustainable solutions for our customers with the best environmental results. This includes:

- working with the EA to demonstrate where data shows phosphorus removal will contribute to water quality benefits, and where it won't
- demonstrating where else a catchment permitting approach could be successful, and linking with catchment offsetting to deliver wider natural capital benefits
- demonstrating the effects of abstractions to inform where licences should be changed and to what extent
- highlighting where additional treatment is required to remove certain chemicals – for example, zinc at Shepton Mallet water recycling centre.

Wildlife and conservation

Our proactive conservation programme is set out in our Biodiversity Action Plan (BAP), through which we aim to halt or reverse biodiversity loss on our land. Our compliance with the national Site of Special Scientific Interest (SSSI) target is now at 99.5% of 293 ha of SSSI-designated land in favourable or recovering condition – of which 62.5% is in favourable condition. This exceeds the national target of 95% in favourable or recovering condition, with at least 50% in favourable condition.

This year we have made great progress towards fulfilling a company performance commitment to assess 100% of our landholding for biodiversity by 2020, with a view to bringing as much as feasible into appropriate management. By the end of 2017-8 we had:

- assessed 90% of 2,157 ha of eligible land
- mapped more than 1,500 ha terrestrial habitats
- found 270 ha of UK priority habitats at 85 locations, all mapped and given a condition rating where appropriate.

In 2015, we appointed a part-time conservation, access and recreation (CAR) officer to help improve these elements of our landholding for the public. The role is to oversee and co-ordinate CAR projects at some of our largest and most visited sites, and those of greatest importance for wildlife and heritage.

Our drop-in National Meadows Day celebration event at Sutton Bingham reservoir was a great success. Activities included a meadow iSpot, a meadow trail and quiz, sow your own wild flower and a 'meadow mayhem' giant board game.

Reduced carbon footprint

One of our long-term sustainability goals is to be carbon neutral in our operations. Our net greenhouse gas emissions fell to 122 kilotonnes carbon dioxide equivalent in 2017-18.

This was our lowest since 1999-2000 and meant we met our performance commitment for the year. As in previous years it was achieved through a combination of energy efficiency improvements, renewable energy generation and the falling carbon dioxide intensity of UK grid electricity.

While our electricity use increased slightly from 2016-17 due to wetter conditions, it remained in line with the downward trend from its peak in 2007-08; this is largely through concerted energy efficiency work which is delivering around four gigawatt hours of savings each year.

Following installation of advanced anaerobic digestion and associated electricity generation at Trowbridge water recycling centre in 2015-16, we are making good progress with a scheme to improve digestion at Berry Hill, near Bournemouth.

Meanwhile, our operating division GENeco continues to export biomethane to the local gas grid, and struck an agreement with Bristol Energy, in addition to the sale of green gas certificates to Unilever.

Innovation

Our vision is to be an acknowledged leader and exemplar at innovation, introducing new ways to benefit the people we serve and the environment around us.

Our innovation strategy involves four broad themes:

- projects that break new ground
- partnering with others who can introduce us to innovative thinking, practices and technologies
- staff who explore ways to do things differently and a culture that allows appropriate levels of risk taking, while embedding innovation into regular practice
- systems and processes that are robust but do not stifle creativity.

STRATEGIC REPORT (continued)

Trials of new technologies and products offer a relatively quick and low risk way to understand the suitability of others' innovations. These commonly originate from contacts with technology developers or intermediaries such as Isle Utilities. We have achieved some significant savings in recent years in areas such as trenchless sewer rehabilitation.

Our current environmental investigations programme is the biggest to date. As well as acquiring the knowledge needed for decisions over future investment, the programme includes projects where we are trialling relatively new techniques.

We are increasingly interested in customer and community-facing innovation. This includes better ways to conduct day to day interactions (which increasingly take place online); community engagement and awareness-raising; and improving our assistance for low income households and vulnerable customers.

We are building a culture of innovation throughout the organisation. At the centre of the innovation 'community' within Wessex Water is a cross-departmental innovation and technology forum which oversees smaller trials, while our employee suggestions scheme, *Eureka*, is a long-standing method for rewarding ideas based on impact and originality.

Research partnerships include work with academia (notably with the University of Bath) and involvement with UK Water Industry Research – the main vehicle for collaborative research between water companies.

Customers and communities

In recent years we have introduced new ways to improve our customer service for all, such as our online interactive map showing all the live jobs that we are carrying out in our region, our Go the extra mile programme which encourages staff to find ways to wow the customers they encounter, and the cash back meter option guarantee devised with our Young People's Panel. We are

improvements, such as real-time feedback dashboards for call centre staff and an improved online portal through which customers can pay bills and see their water consumption data.

The second of these complements our own efforts for improving water efficiency and reducing leakage, such as the roll out of 'hydrophones' which are acoustic devices that spot leaks from water mains from their particular sound signature. The completion of the integrated water supply grid also includes an innovative control system – the optimiser – which can work semi- autonomously to keep pumping costs down and ensure security of supply.

In 2017-18 we increased the use of mapping tools and other analytical methods that plot areas of deprivation, allowing more targeted contacts with low income households. We are developing an online portal for use by partner charities and are sharing data with energy providers where it helps the most vulnerable customers.

The interactive online game to support the 2019 business plan represents a more innovative way to understand customer priorities compared to methods we have relied on in the past. Meanwhile, we are investigating novel methods for helping our customers through digital platforms and, in the longer term, smart home technologies using artificial intelligence.

Early work to improve drinking water treatment at Durleigh reservoir has benefited from our use of an 'Iglloo' – a wrap-around virtual reality pod in which several people can simultaneously view digital models of sites. Also at Durleigh, we are working with University of Bath researchers on methods for preventing discolouration of water due to manganese, and installing a constructed wetland to reduce influxes of sediment to the reservoir.

Elsewhere we are working to introduce the use of ultraviolet light as an alternative form of disinfection in water treatment and are using a remotely operated vehicle cleaning unit to clear silt from service reservoirs that cannot be cleaned by more conventional means.

Environment

We won the 2017 Institute of Water national innovation award for the catchment permitting programme we have co-designed with the Environment Agency in the Bristol Avon and our innovative environmental trading scheme EnTrade.

STRATEGIC REPORT (continued)

Some of the new techniques trialled this year, some of which are part of our extensive environmental investigations programme, included:

- the use of brief spate flows from Durleigh reservoir into the downstream watercourse to remobilise phytoplankton that had settled, causing poor ecological results
- monitoring sediment movement downstream of Sutton Bingham reservoir using radio frequency tags and time lapse photography
- mobile kiosks housing river quality analysers that upload data every half hour
- novel treatment methods for reducing phosphorus in effluent, including the use of Bio-mag, a material that uses magnetite (an oxide of iron) to improve settlement in sewage treatment and an algal pond designed by the University of Bath, populated by locally dominant varieties of algae
- working with local public health practitioners on ways to encourage people to take more exercise and have more contact with the environment, which could in turn alter medicine prescribing and reduce the impact of pharmaceutical residues on the water environment
- the use of a short lived bacteriophage dosed at Taunton water recycling centre to determine the time treated effluent takes to travel to Burnham Jetty bathing water via the river Tone. At Highbridge water recycling centre we have installed ultraviolet disinfection of the overflow from storm tanks for the first time. We have also been involved with community engagement projects such as Litter Free Coast and Sea, which promote behaviour that benefits beaches and their immediate surroundings.

We continued to introduce innovative methods for surveying and repairing sewers including:

- a cured in place liner for a rising main (a UK first)
- million point photographic scanning which produces very accurate imagery that we use when surveying tunnels
- the use of calcium aluminate cement as a means of preventing corrosion in concrete from hydrogen sulphide
- a hydrodemolition cannon that is used to clean calcite from sewers or cut through concrete using needle point water pressures of up to 15,000 psi.

Partnerships

Our partnership with the University of Bath was founded on an initial research programme focusing on sustainable water and waste water management; and the creation of the Water Innovation Research Centre. Other key elements include:

- work with PhD students – many of whom are funded by EPSRC in the Water Informatics: Science & Engineering Centre for Doctoral Training

Our innovation culture

Last year our Eureka programme received 62 suggestions, with four deemed suitable for further development or reward.

We held our inaugural innovation day, with participation from PWC, Vodafone, Microsoft, the University of Bath, Isle Utilities, Wessex Water Services Ltd and companies in the wider Wessex Water group. On the day there were more than 600 individual session attendances and online views, and we followed up with a series of breakfast roadshows, taking excerpts from the day to five other sites around the region.

Meanwhile, we have been developing a number of tools in-house to improve our innovation process. These include:

- an innovation capability maturity model to help clarify our current capabilities and gaps that should be addressed
- a 'funnel' framework to keep track of innovation projects across a series of stages, and a database of past projects.

In April we celebrated a royal seal of approval after being awarded the Queen's Award for Enterprise for a third time. We were nominated in the Sustainable Development category of the awards, which are the UK's highest accolade for business success. We first committed to becoming a sustainable company in 1996, and our sustainability vision is embedded into all planning, targets and day to day work. The award recognises the further progress made since we last received the same accolade in 2013.

We pride ourselves on going beyond business as usual in all areas, from our work on social tariffs and debt advice to catchment permitting and online nutrient trading.

STRATEGIC REPORT (continued)

Employees

We aim to be an employer of choice and provide all employees with the opportunity to develop to their full potential and have a rewarding and satisfying career.

We actively encourage and provide opportunities for our people at all levels within our business to consolidate their learning and upskill to a national standard through further education or professional development programmes. This ensures employees can enhance their competency, skills and expertise to enable them to perform at the highest levels. Our workforce is highly motivated and engaged and consistently provides outstanding and industry leading levels of customer service.

Apprenticeships are a key element of our resourcing strategy to build and maintain a sustainable workforce to meet current and future needs. We are proud that more than 8% of our workforce are undertaking long-term learning and development through apprenticeships, further or higher education. Due to this success, we have joined the government's 5% Club which recognises that, as an employer, we provide opportunities to develop the skills and talents people need to become more employable and create meaningful careers. Through this membership we have committed to always have a minimum of 5% of our workforce enrolled as apprentices, sponsored students or on a graduate development scheme.

This year we have created an early careers team dedicated to providing career development opportunities throughout the group. We have designed and implemented a dedicated operations graduate programme and in addition arranged and coordinated an industrial placement programme for six areas in engineering and construction.

Our aim is to develop a cohesive early careers and graduate community across the business, bringing together all our talent and senior managers, from all business areas, on a regular basis to support, share knowledge and learn from each other. Thus ensuring we have a strong and robust talent pipeline for the future and an innovative and flexible approach to development that ensures we continue to have a highly competent workforce. We recognise the importance of nurturing talent across the business and continue to deliver and develop a range of initiatives that support career progression, including development centres, new management development programmes, coaching and mentoring.

This year, we launched our People Programme, a five-year plan to oversee and invest in a series of activities to benefit our people and help build a sustainable workforce for the future. Some of the areas we have focused on have included wellbeing, launching our new e-learning platform, iLearn, and developing a blended approach to learning.

Promoting and encouraging diversity and inclusion has again been a key focus this year. We firmly believe the diversity of our workforce should reflect the community we serve. We recognise that difference in personal characteristics is positive and brings richness to our work environment that is essential to our continued success. We continue to develop and implement a range of diversity initiatives and to promote flexible and remote working, together with flexible retirement aimed at easing people into retirement gradually. Protecting the health, safety and welfare of our staff, contractors and customers remains the highest priority.

Training

Training and development continues to be an important focus and we have delivered more than 800 courses with an average of 3.4 days' development training per employee.

We continue to work in partnership with selected local colleges and universities to enhance our management development programmes. In partnership with the University of the West of England, we delivered our third cohort of Institute of Leadership and Management (ILM) Level 5 programmes and one cohort of ILM Level 7 programme in Strategic Leadership.

We continue to invest in two-day development centres for nominated high potential employees as part of our talent and succession planning. This has led to secondment and development opportunities, providing our people with identified career development.

We continue to deliver in-house development programmes for new and experienced managers as well as a full soft skills training programme. Our new e-learning system, iLearn, has been developed to complement, reinforce, and further embed a culture of learning

Coaching and mentoring initiatives continue to enhance and benefit individuals at all levels. We ran a mentoring programme in partnership with a local secondary school to offer students the opportunity to work on a one to one level with our people

STRATEGIC REPORT (continued)

Apprentices

We continue to engage our local young people in apprenticeships, holding two apprenticeship open days this year, with one held in November to coincide with National Engineering Week where we promoted the company and the career opportunities available to young people in our business.

In addition to our education team, our apprentices have visited 28 schools and career fairs around the region, encouraging young people to consider apprenticeships as a career option, and the water industry as a future career avenue. All this has led to an increase in the demand for apprenticeship positions this year.

We are proud that 17% of our apprentices this year are female, reflecting the work we do to engage young women in our sector.

Aiming to ensure the best use of the government apprenticeship levy, we have this year introduced career development apprenticeships for existing members of staff. These apprenticeships are open to staff within the business to enable them to reach their potential and progress their careers within the company.

Diversity

We value the differences that a diverse workforce brings and are committed to creating and promoting an inclusive workplace for all employees and others who work with us as suppliers, contractors or customers.

We continue to emphasise the promotion of diversity and inclusion within the company, ensuring everyone has an equal chance to progress their career with us regardless of age, gender, sexual orientation, ethnicity, disability, cultural background and carer responsibilities.

Diversity and inclusion remain a key focus for us and our aim is to reflect the community we serve.

Culture

We have a strong, friendly and positive culture, and staff enjoy working for us and with each other. We held a staff survey this year and 84% of employees rated us a good company to work for and 76% rated us a great place to work. Our staff engagement was 80%. Our employees are important to us and we listen to their feedback and put action plans in place to address key areas.

Health and safety

The management of health and safety is critical to our success and embedded across all business areas to ensure we maintain our position as a responsible, safe employer where all employees can work safely and reach their full potential.

Protecting the health, safety and welfare of our staff, contractors and customers is a shared responsibility and we continue to build a strong health, safety and welfare culture in our day to day operations.

Our target is for zero accidents and we monitor all accidents, incidents and observations reported by employees. The information we collect assists in determining problem areas or emerging trends and allows resources to be allocated to prevent accidents or illnesses.

In support of this we have introduced a health and safety incident and observation app that allows staff to quickly and easily report safe and unsafe conditions. All reports are reviewed and any that raise significant concern are subject to additional investigation and remedial action.

Position for the 12 months to 31 December 2017:

- 551 incidents reported (a slight increase of 2% from 2016)
- one reportable dangerous occurrence and two reportable diseases
- 11 incidents were notifiable to the Health and Safety Executive (an increase of one from 2016)
- 263 working days lost through notifiable incidents (an increase of 14% from 2016)
- overall reduction of 32% in total lost-time accidents across the company
- no enforcement action from the Health and Safety Executive.

STRATEGIC REPORT (continued)

Take 5 to Check 5

Take 5 to Check 5 (T5C5) was launched at staff seminars in April 2017 which all staff were invited to attend. T5C5 is a simple to use, dynamic risk assessment that allows staff to stop and get advice wherever they feel that it is not safe to continue work. To promote safety outside work, staff were shown how easily T5C5 can be used in the home for DIY, gardening, etc.

Health and safety incident and observation reporting app, an enterprise-wide Wessex Water health and safety incident, near miss and observation reporting app has been introduced and will replace existing paper based systems used for reporting incidents, near misses etc.

The app, based on Power Apps, was developed by the IS offshore development centre in Kuala Lumpur and can be used on smart phones, tablets and laptop/pc. Staff can now quickly report safe or unsafe observations and include photographs where appropriate. The app is now in use within operations, engineering and construction and GENeco. It will be rolled out to the rest of the company in 2018.

Lone worker safety

A review of the existing system for lone worker protection identified a need to provide an improved and more robust solution using modern technology.

During the year we have reviewed the requirements for a lone worker protection system.

A Wessex Water standard specification has been developed and used to identify a fit for purpose corporate solution for the next 10 years. After extensive field trials and competitive tendering, Lone Worker Solutions have been selected to provide lone worker services for Wessex Water. The new system is being rolled out across the company and will be completed in May 2018.

Mental health

Stress, anxiety and depression remains a minority reason for overall absence although it is on the increase. The priority we place on the wellbeing of our people has been strengthened and is an integral part of our People Programme.

During 2017 staff attended resilience building training trials to determine its suitability for wider implementation across the company. Feedback from staff was positive and seen to be beneficial and we plan to offer staff this training over the coming year.

Health and safety awards

Our commitment to safety and performance has again been recognised by RoSPA.

Engineering and construction were awarded the 2017 Construction Engineering sector award. These awards are presented annually for the most outstanding performance in health and safety by a company or organisation within a particular industry or sector. Winners must demonstrate a robust and high quality safety management system together with a minimum of four years' consistently excellent or continuously improving health and safety performance.

Engineering and construction were also nominated for the prestigious Sir George Earle trophy that we won in 2016. Despite a strong performance we were unsuccessful this time.

The company was also recognised in the Utility Week awards with the Health and Safety Initiative of the Year award for collaborative work in the utility sector. Our winning roadworks safety campaign is in collaboration with the charity SafeWise and includes a hard hitting video designed to influence driver behaviour near roadworks.

We have continued to work with SafeWise to promote safety at roadworks and look for new areas to work with them to influence the behaviour of customers and children who interact with our daily activities.

STRATEGIC REPORT (continued)

Financial performance

Introduction

The UK group structure has remained the same since 2002 with the Company wholly owned by Wessex Water Limited, which in turn is wholly owned by YTL Utilities (UK) Limited. Neither of these entities provide any intra-group funding to the Company with virtually all of the debt raised for the UK group sitting within the Company and all borrowings at market rates provided by financial third parties.

Gearing, as measured by net debt to RCV, stands at 64%. On a pensions-adjusted basis, this figure rises to 68%, which the board still finds an acceptable level. During the year the board has continued to pay particular attention to the projected level of the company's gearing ratio with a view, when declaring dividends, to protect the company's existing credit ratings. The board remains committed to maintaining good investment grade credit ratings for the company at all times.

The latest actuarial valuation of the company's pension scheme took place on 30 September 2016, showing a deficit of £160.9m. The company has agreed with the scheme's trustees a payment recovery plan in respect of the deficit comprising employer contributions of 21.7% and special contributions to reduce the deficit. The special contributions are £11.0m on 31 March 2018 and £11.0m plus inflation annually through to 31 March 2024. The company is committed to honouring the special contribution obligations it signed up to.

Following the latest actuarial valuation of the pension scheme a consultation was held with members to discuss the future funding of the scheme. As part of that consultation the Company, trustees and members agreed that the measurement of inflation for future pension increases would change. From 2020 pension increases for active members will be measured using Consumer Price Index (CPI) rather than Retail Price Index (RPI) which is currently used.

The company has an adequate liquidity position comprising cash and cash equivalents held on the balance sheet along with undrawn bank facilities, giving the company instant access to funding if needed. The company is also in negotiation to secure a new £140m bank loan to replace an existing one that matures in December 2018.

Taxation strategy

The Company adopts a risk averse and cautious approach to tax. The Company seeks to comply with the spirit and letter of UK tax legislation and claims all tax reliefs and allowances that it is entitled to. The Company does not enter into complicated structures nor engages in any aggressive or artificial tax planning, as it does not believe it is the correct thing to do.

Due to the size and complexity of the UK tax system, tax is a complicated area and uncertainties will arise. Consistent with other business areas it seeks external advice when required.

The Company has an open, regular and professional dialogue with HMRC. HMRC renewed its low risk rating for the Company last year for a further three-year period. The Company is keen to maintain this low risk status in the long term. The Company believes that its approach to tax and early engagement with HMRC on any area of uncertainty are significant factors in maintaining this low risk rating.

The current year corporation tax charge was £21.0m, which represented an effective tax rate of 15% on profit excluding exceptional items. This is lower than the statutory rate of corporation tax of 19% due to the availability of tax allowances available to the Company.

In addition to corporation tax, the Company is also liable to a number of other taxes, which represent a cost to the business, including employer National Insurance contributions, business rates, environmental taxes and Insurance Premium Tax.

Financial performance

The third year of the AMP6 price review period saw a slight decrease in the profitability of the Company, with operating profit excluding exceptional items falling by £6.2m from £233.5m to £227.3m. There was an increase in turnover of £10.5m and a £16.7m increase in operating costs excluding exceptional items.

Turnover

Turnover increased by £10.5m or 2.0% from £531.1m to £541.6m. At April 2017 the market was split between household and non-household customers and from 1 April 2017 there was a price increase of 0.4% plus November RPI of 2.2% for household and an increase of 3.4% for non-household. The turnover increase was in line with the price increase allowed by Ofwat as the impact of tariff switching and economic conditions was broadly neutral.

Total expenses

Total expenses (excluding exceptional items, depreciation and amortisation) increased by £9.4m from £198.1m to £207.5m as the increases in repair costs, site operations, pension costs and EA charges exceeded cost savings made.

STRATEGIC REPORT (continued)

Depreciation and amortisation

Depreciation costs increased by £7.3m, from £99.5m to £106.8m. There was an increase in underlying depreciation from assets capitalised and a one-off profit on sale of the retail customer book in the prior year was not repeated in the current year.

Capital investment

In the regulatory year to 31 March 2018 we delivered gross capital expenditure for the second year of the AMP6 programme of £250.4m, which was £36.4m higher than the £214.0m delivered in the previous year.

Interest charges

Net Interest charges increased from £75.7m last year to £86.1m this year. The £10.4m increase was split between an interest payable increase of £9.4m, a £0.6m decrease in interest receivable, and a £0.4m increase in pension related costs.

The £9.4m increase in base interest costs was a result an increase in the cost of debt from 4.0% to 4.4% over the year and an increase in net debt over the year from £1,914.6m to £2,013.5m.

There is a prudent mix of debt between fixed rate, index linked and floating rate instruments. At the year-end the debt split was 47% fixed, 37% index linked and 16% floating, with the index linked debt based on either November or March RPI. The maturity of debt is generally long term with £1,880.8m of debt maturing after 2020.

Taxation charge

The Company has a statutory year-end of 30 June and the tax computation is prepared for the 12 months to 30 June each year. Corporation tax is paid quarterly.

There was a £41.0m increase in taxation from a charge of £7.0m last year to £48.0m this year. The two main items explaining this difference relate to deferred tax items. Firstly, the reduction in the Corporation tax rate to 17% was reflected in the prior year charge, resulting in a tax credit of £20.7m in the prior year. The 17% rate remains in force as at 30 June 2018. Secondly, during the period the Company decided to align its deferred tax accounting in relation to historical buildings with the parent company methodology. This has resulted in a £16.6m deferred tax charge which has been disclosed as an exceptional item as described in note 4 on page 74.

Dividends

Wessex Water's dividend policy is to declare dividends consistent with the Company's performance and prudent management of the economic risk of the business. The Board has agreed to ensure that gearing stays at or below 70% in order to maintain its current credit ratings and give the Company continued access to the capital markets.

Cashflow and gearing

Net debt increased by £98.9m from £1,914.6m to £2,013.5m. This comprised:

- earnings before tax, interest and depreciation of £370.0m, less
- cash outflow from capital investment of £232.4m, less
- interest and tax payments of £83.6m, less
- working capital and bond accrual outflow of £65.9m, less
- dividend payments of £87.0m.

Liquidity at year end was £158.7m comprising £8.7m of cash and cash equivalents and £150.0m of facilities not yet drawn down.

Principle Risks

Our industry-leading customer and environmental performance has been achieved through a focus on understanding the risks we face and using innovative approaches to mitigate risks and create opportunities to improve the services we provide.

The company's policy on risk assessment and management is subject to regular review by the board. The identification and management of risk is delivered through a hierarchy of risk management reviews from operational staff, senior management, executive directors to the Wessex Water Services Limited Board. The board reviews and holds ultimate responsibility for the risk process and for the identification and mitigation of risks.

STRATEGIC REPORT (continued)

The Risk and Resilience Management Group meets through the year and submits the current risk register and summary report every six months to the Risk Management Advisory Group made up of the executive directors. This group scrutinises and challenges the risks included in the register and identifies any additional work it thinks is necessary to better classify the risk or explore other mitigation methods which may be available. Any significant new risks are reported to the advisory group and to the board as they arise.

The Managing Director submits an annual risk review paper to the board for its review and agreement. This paper details the risk review process, identifies the current principal risks (listed below) to the business and the mitigation measures in place. It also records the status of emergent risks that have been identified.

Since the last annual review, the following changes have been made to demonstrate the increasing focus that risk now plays:

- The Audit Committee has been re-named the Audit & Risk Committee.
- The WWSL Services Management Team now has a standing item on risk at each monthly meeting.
- Clearer lines of responsibility from the Board, through Executive Directors to the Risk and Resilience Management Group.
- Detailed assessments of the effectiveness of each risk mitigation action have been developed.
- A process of reviewing of whether the risks are currently in or out of tolerance has been introduced.

The board has agreed the addition of one principal risk relating to the information management issues regarding the General Data Protection Regulation (GDPR) which is enacted in May 2018.

- **Government/regulatory action.** Market uncertainties reflecting the Brexit vote, political intervention and the format of the next (PR19) price control are all reflected in this risk. Relationships with politicians and regulators are maintained so that the company's views about the effect of any proposed legislative changes on the company and its customers are heard.
- **Major pollution incident.** Significant effort is made to prevent such an incident occurring through staff adherence to company processes and procedures. Local emergency plans are in place to protect the local environment at key installations and monitors are being installed to mitigate the risk at critical locations.
- **Digital resilience.** Most activities undertaken by the business are reliant on the availability of IT services and facilities and the company continues to examine ways in which IT resilience can be maintained and, where appropriate, improved. While regular improvements continue to be made, the threat persists with an increase in attacks being experienced. The quarterly Information Security Forum maintains the focus on mitigating this risk.
- **Health and safety incident.** Serious injury or death of a staff member or third party could expose the company to prosecution under health and safety legislation and the Corporate Manslaughter Act. Health and safety is of paramount importance to us with processes and procedures implemented through staff training and regularly monitored to maintain compliance and to protect people from harm. Our 'Take 5 to Check 5' initiative has been successful in maintaining the focus on health and safety and our approach continues to be recognised through national awards.
- **Resourcing and skills.** There is already a recognised short-fall in STEM skills (Science, Technology, Engineering and Maths), which is compounded by the uncertainty from the Brexit vote and heightened in our region by the impact of the Hinkley Point C programme. As expected this situation is becoming more challenging and we our People Programme is helping to mitigate this risk.
- **Insider threat.** Considerable damage could be done to the company's reputation by a rogue or radicalised employee or contractor. References are obtained for all new starters, whether permanent or contract. DBS checks are undertaken for all new permanent and fixed-term staff and for agency staff working in sensitive areas of the business. Further mitigation plans are being developed to counter what is one of the most significant risks on the national risk register.
- **Information management (GDPR).** The programme plan will achieve compliance with the regulations. Further cultural, process and systems improvements will continue to be made to improve our resilience.
- **Anti-competitive behaviour.** We remain vigilant after the opening of the non-household market. Our competition team meets monthly to consider emergent issues and risks and appropriate actions to ensure we continue to comply with the Competition Act.
- **Availability of new finance.** The bond markets are used extensively to fund new investment. The current economic climate post Brexit vote has shown the volatility of these markets. The relationship with bond markets and rating agencies will be maintained and the board will continue to ensure that the company operates within prudent financial parameters. This annual review includes our long-term viability statement which includes modelling the main financial risks.
- **Outcome delivery incentive failure.** The business is focused on achieving the targets. While processes, data and culture are all embedded, risks remain following another year of generally benign conditions. As well as reputational risk there are also financial penalties which can be incurred if we do not remain vigilant and continue to stretch ourselves to improve the service to our customers.

STRATEGIC REPORT (continued)

- Widespread unfit water. The completion of our integrated water supply grid and the removal of standalone sources for most of our customers means we have improved our resilience against the risk of a major failure of process or contamination of the water supply. Nevertheless, we continue to challenge ourselves to improve and risk assessments are formally reviewed at the monthly risk meetings and where appropriate mitigation action are implemented throughout the year.

While the corporate risk register holds 80-100 risks at any time, the principal risks are those that the board consider could have a material impact on the capability of the business to perform its functions. All these risks are subject to active mitigation strategies and the board considers that the company is taking appropriate action to mitigate the severity and likelihood of those risks to an acceptable level.

Board of Directors

Executive Directors

Colin Skellett – Chief Executive

A chartered chemist and engineer by training, he has worked in the water industry for more than 40 years, holding a number of positions in the management and control of both water supply and sewage treatment.

He joined Wessex Water in 1974 and was appointed its Chief Executive in 1988. Colin oversaw the move from the public to the private sector and the transformation of Wessex Water into a highly rated water company. Colin was awarded an OBE for services to business and WaterAid in the 2012 Queen's Birthday Honours and has an Honorary Doctorate in Engineering from the University of the West of England. He was Chairman of the West of England Local Enterprise Partnership until January 2016.

Mark Watts – Director of Finance

A qualified treasurer, Mark spent eight years in international banking before joining the treasury department of Wessex Water in 1991. He was appointed Treasury Manager in 1994 before becoming Treasurer in 1999.

Mark is highly experienced in raising finance, from both the capital markets and the banking sector, as well as having a long history in dealing with various corporate finance issues. He was appointed Finance Director and Treasurer on 16 March 2010.

Andrew Pymmer – Managing Director

A chartered civil engineer turned economist, Andrew has more than 25 years' experience in the water sector, holding roles both overseas and in the UK. He was appointed Managing Director in 2016 having previously been Director of Regulation and Customer Services.

Andrew is also co-Chair of Wessex Water's joint venture billing provider, Bristol Wessex Billing Services Ltd, and Chair of Wessex WaterAid, which has raised more than £1.5m for the charity over the past 10 years.

James Rider – Chief Operating Officer

James is a Fellow of the Chartered Institute of Water and Environmental Management with more than 25 years' experience in the water industry. He started as a technician engineer in 1990 and has since held a wide range of roles within operations, engineering and construction, information and technology and billing and customer services.

Non-Executive Directors - Independent

Gillian Camm – Senior Independent Director

Appointed in November 2011 and Chair of the Wessex Corporate Responsibility Committee. Deputy Lieutenant Gloucestershire, vice president Quartet Community Foundation, member Society of Merchant Venturers, Chair of Leadership Foundation for Higher Education.

Huw Davies FCA

Appointed in September 2014 and Chair of Pension Trustees and Audit Committee. Former chief financial officer of Wates Group Ltd, non-executive director of J Murphy Ltd, and Chair of I CAN the childrens charity for speech, language and communication needs.

Fiona Reynolds DBE

Appointed in August 2012 and chair of the Futures Panel. Master of Emmanuel College, Cambridge from September 2013. Other non-executive roles include Chair of the Cathedrals Fabric Commission for England, Chair of the Green Alliance and Non-Executive member of the John Lewis Partnership Corporate Responsibility Committee. Director-General of the National Trust from 2001 to 2012.

STRATEGIC REPORT (continued)

Richard Keys

Appointed in 2016. Chartered accountant, former partner and head of PwC's global accounting consulting group. Currently, non-executive director, NATS Holdings Limited; non-executive director, member of the Departmental Board, The Department for International Development; non-executive director Merrill Lynch International; recently retired as non-executive director Sainsbury's Bank plc.

Non-Executive Directors - Shareholder

Francis Yeoh CBE (Chairman)

Managing Director of YTL Corporation Berhad, Malaysia since 1988. A founder member of the Malaysia Business Council, member of Malaysia's Capital Markets Advisory Council and Independent Non- Executive Director of The Hong Kong and Shanghai Banking Corporation Limited. Director since May 2002.

Hong Yeoh

Director of YTL Corporation Berhad, Malaysia since 1985, Executive Director of YTL Power International Berhad. Responsible for YTL Group's utilities and construction divisions. Director since May 2002. Chairman of Remuneration Committee.

Mark Yeoh

Executive Director responsible for the YTL hotels and resorts division. Graduated from King's College, University of London with an LLB (Hons) and was subsequently called to the Bar at Gray's Inn, London in 1988. He joined the YTL Group in 1989 and serves on the Board of YTL Corporation Berhad, YTL Power International Berhad, YTL Land & Development Berhad, YTL Cement Berhad and Wessex Water Limited. Director since October 2003.

Hann Yeoh

Non-Executive Director of Wessex Water since August 2012. Executive Director of YTL Power Generation Sdn Bhd (wholly-owned subsidiary of YTL Power International Berhad) and part of the business development team of YTL Power International Berhad.

He also sits on the Board of YTL PowerSeraya Pte Limited in Singapore and is a graduate of Oxford University with a Master of Engineering in Engineering Science.

David Barclay

Former Vice Chairman of Dresdner Kleinwort and Non- Executive Deputy Chairman of John Lewis plc. Senior Independent Director of Wates Group Limited. Deputy Chairman of the Board of the British Library. Appointed 1 November 2005.

The Strategic Report was approved by the Board of Directors on 16 October 2018 and signed on its behalf by:



Mark Watts - Director

GOVERNANCE REPORT

Introduction

Wessex Water is committed to high standards of corporate governance. Under Condition F of its Instrument of Appointment as a water and sewerage undertaker (the “Licence”) Wessex Water is required to conduct its water and sewerage business as if it were the Company’s sole business as a public limited company. The Licence also requires Wessex Water to have particular regard to the UK Corporate Governance Code as approved for the purposes of the Listings Rules of the Financial Services Authority (the “Code”). The Code is not a rigid set of rules and provides general principles of best practice. The Code is made up of “Main Principles”, “Supporting Principles” and “Code Provisions”. The Code Provisions are subordinate to the Principles. Whilst the Code is generally regarded as embodying best practice in UK Corporate Governance, its main focus is the relationship between a listed company and its shareholders. Wessex Water has a single shareholder and, accordingly, it is able to address some issues more directly and completely than it could if it were a listed company.

The Company’s focus is on complying with the Principles and spirit of the Code in its particular context as a private limited company with a single shareholder. In practice, the Company complies with the Code Principles and Code Provisions with only very limited exceptions. In those few areas where we have decided not to follow the precise requirements of the Code we explain why, and how good governance is nevertheless achieved.

The following parts of this Governance Report explain how good governance is at the heart of the Company’s business and underpins the Company’s relationships with its customers, shareholder, and other stakeholders. The Board regards it as fundamental to the long-term success of the Company to provide excellent customer service and satisfaction. Governance arrangements are kept under constant review. We continue to reflect best practice and maintain our position as the leading water and sewerage company for customer service and satisfaction. We have set out our commitment to best practice in our Code of Practice for Corporate Governance a copy of which is available on our website.

We believe that our governance arrangements ensure that we continue to operate effectively and efficiently to the benefit of our customers, shareholder, and other stakeholders with clear accountability for decision making.

Governance Structures - The Board

The affairs of the Company are ultimately the responsibility of the Board, which controls and directs the undertaking of the regulated water and sewerage business.

The Board annually reviews and approves the Company’s Organisation and Control Arrangements (O&CA) which set out the framework for control of the Company’s affairs. The O&CA also specify requirements for the competency of members of the Board and its Committees, for effective management of the Company and for the granting of delegated powers and authorisations.

The principal duties of the Board, the matters reserved for its decision and the terms of reference of its Committees are fully documented and copies are available on our website. Matters reserved to the Board include strategy, charges, material changes to the Company’s management and control structure, Board appointments, approval of material contracts, risk management, health and safety policies, disposal of material assets, approval of the annual operating budgets, employee pension arrangements, significant changes in accounting policies and defence and settlement of material litigation.

There are no matters specifically reserved to the shareholder. In practice the Board operates (and has operated continuously for more than a decade) without the requirement for shareholder resolutions. As part of its responsibility for the management of risk, the Board has determined criteria which control the extent of dividends paid and consequently the financial gearing of the Company. As with all Board decision making, these criteria were determined with the active involvement of the Independent Non-Executive Directors.

There are four Executive Directors. During the year there were four Independent Non-Executive Directors, exceeding by one the requirements of Condition P of the Licence. Four further Non-Executive Directors are appointed by the Company’s sole shareholder, plus an alternate director. The shareholder also appoints the chair.

This balance on the Board ensures a high level of engagement and dialogue with the Company’s customers and shareholder. In this way, the Company complies with and exceeds the principles and spirit of the Code without the need for compliance with certain specific Code Provisions (including those in relation to the use of an annual general meeting to communicate with investors and encourage participation) which are not relevant to a company with a single shareholder.

The Non-Executive Directors scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. The Independent Non-Executive Directors, led by the Senior Independent Director form or participate in the various Company Committees, assess the integrity of financial information and whether financial controls and systems of risk management are robust and defensible, determine appropriate levels of remuneration for Executive Directors, assisting in appointing and, if necessary, removing Executive Directors, and assisting in succession planning.

The Board ensures that Directors (and in particular the Independent Non-Executive Directors) have access to independent professional advice at the Company’s expense where they judge it necessary to discharge their responsibilities as Directors. The Board also ensures that the Committees are provided with sufficient resources to undertake their duties.

GOVERNANCE REPORT (continued)

The Company arranges appropriate Directors' and Officers' insurance against the usual legal risks faced through holding office.

If Directors have concerns about the running of the Company or a proposed action which cannot be resolved, they are encouraged to ensure that their concerns are recorded in the Board minutes and the Independent Non-Executive Directors are encouraged, on resignation, to provide a written statement to the Chairman highlighting any such concerns.

Due to the Company having a single shareholder, the Code provisions in relation to Directors being subject to annual election by shareholders are of limited relevance and not applied.

The Company complied with the Code's Main Principles and Supporting Principles as to the composition of the Board. Moreover, the Company exceeded the requirements of the Code (designed for listed rather than privately held companies) by having no fewer than four Non-Executive Directors, during the reporting year who are directors or employees of the Malaysian holding company, thus enabling effective dialogue with the shareholder.

While the Board has a majority of Non-Executive Directors, it does not have a majority of Independent Non-Executive Directors as envisaged by the relevant Code Provision. The Ofwat Board Leadership, Transparency and Governance Principles are based on the Code, which applies to UK listed companies. The principal purpose of the Code is to ensure that the interests of a company's members are protected and represented at board level. The preface to the Code states that: "the function should be to help boards discharge their duties in the best interests of their companies." The preamble to the Ofwat Principles states that: "any departures from the [Ofwat] principles should be by exception in the spirit of corporate governance for listed companies." In the context of a privately held company with a 100 percent shareholder, we consider it to be in accordance with good corporate governance practice for there to be a significant number, if not a majority, of shareholder representatives on the Board. In the Company's case, the shareholder appointed Non-Executive Directors (excluding the Chairman) are not a majority on the Board. Further, the Company has four highly capable and experienced Independent Non-Executive Directors.

The Board considers its current composition ensures an appropriate balance of skills, experience, independence and knowledge so that no single group can dominate decision taking and that the Board does not become too unwieldy.

The search for Board candidates is conducted, and appointments and re-appointments are made, on merit, against objective criteria, and with due regard to the benefits of diversity on the Board, including gender diversity. All directors receive induction training on joining the Board and regularly update and refresh their skills and knowledge.

The following were Directors during the year under review:

Executive Directors	Independent Non-Executive Directors	Shareholder Non-Executive Directors
Colin Skellett	Gillian Camm (Senior Non-Executive Director)	Francis Yeoh (Chair)
Mark Watts	Huw Davies	Hann Yeoh (Kathleen Chew as alternate)
Andrew Pymer	Fiona Reynolds	Hong Yeoh
James Rider	Richard Keys	Mark Yeoh
		David Barclay

Chairman

Throughout the financial year under review Francis Yeoh was the Company's Chairman.

The Chairman leads the Board, ensuring its effectiveness while taking into account the interests of all stakeholders and promoting the highest standards of business ethics and governance. The Chairman is responsible for ensuring that Directors receive accurate, timely and clear information. The Chairman also promotes a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors, in particular ensuring constructive relations between Executive and Non-Executive Directors and ensuring effective communication with the Company's shareholder. Board agendas are agreed in consultation with other Directors and the Company Secretary.

Any Director or the Company Secretary may request an item be included on the agenda.

New Directors receive a full, formal and tailored induction on joining the Board (including an opportunity to meet with representatives of the shareholder). Further training is given as required.

In his role as Managing Director, Andrew Pymer has responsibility for the day to day business of the Company, making proposals for its strategic direction and communicating with customers and other stakeholders.

GOVERNANCE REPORT (continued)

Senior Independent Director

The Board has appointed Gillian Camm as the Senior Independent Director. Gillian is a member of the Remuneration Committee and the Nominations Committee. As Senior Independent director, Gillian would chair Board meetings if the Chairman were unavailable. The Senior Independent Director's role is to act as a sounding board for the Chairman and to serve as an intermediary for the other Directors when necessary as well as an additional point of contact for the shareholder and other stakeholders.

As the Senior Independent Director appointed in accordance with the Licence, Gillian is well placed to provide an independent link to Ofwat, our regulator. Her responsibilities during the reporting year included leading an independent evaluation of the Board's performance including the Chairman's.

Independent Non-Executive Directors

The Company's Independent Non-Executive Directors are appointed from a range of different backgrounds to bring to the Board external experience and insight. They provide independent thought and challenge to the Board's decision making. The Board has reviewed their status and concluded that they are all independent. In particular, the Board considers these Directors to be independent in character and judgement. The Board are not aware of any relationships or circumstances which are likely to affect, or could appear to affect, any Independent Non-Executive Director's judgement.

Independent Non-Executive Directors are appointed, after consultation with Ofwat and with the agreement of the Company's shareholder, for an initial three-year term (subject to statutory provisions relating to removal) that may be extended.

Any term beyond six years for an Independent Non-Executive Director is subject to particularly rigorous review and takes into account the need for progressive refreshing of the Board balanced against the requirement for skills, experience, independence and knowledge. Continuity of appointment of some Independent Non-Executive Directors between Ofwat price reviews is desirable to facilitate scrutiny of Company performance against its business plan. Accordingly, David Barclay stepped down as a Senior Independent Director in May 2016 (remaining as a Non-Executive Director).

Independent Non-Executive Director	Appointed	Current term expires
Richard Keys	01/05/2016	01/05/2019
Gillian Camm	01/11/2011	01/11/2018
Huw Davies	01/09/2014	01/09/2020
Fiona Reynolds	01/08/2012	30/09/2018

All Independent Non-Executive Directors are appointed on written terms setting the time commitments and standards required of them. In accordance with Code Provision B.3.2, terms of engagement are regulated by letters of appointment (copies of which are available on the Company's website). Non-Executive Directors representing the Company's sole shareholder do not have formal terms of appointment and receive no payments from the Company with the exception of David Barclay, who receives an annual fee under a formal appointment, details of which are published on our website. In accordance with Code Provision B.4.1, all Directors are required to participate in an induction process to familiarise themselves with the Company's governance arrangements, business, regulatory framework and ethos. Introductory meetings are held with all Executive and Non-Executive Directors, the Company Secretary and senior managers across the Company's business.

Visits are made to the Company's principal offices and representative operational sites. The training and development needs of the Executive Directors and Independent Non-Executive Directors are reviewed annually by the Chairman.

Company Secretary

All Directors have access to the Company Secretary and the Company's internal solicitors. The Company Secretary's responsibilities include ensuring good information flows within the Board and its Committees and between senior management and Non-Executive Directors, as well as facilitating induction and assisting with professional development as required. The Company Secretary is responsible for ensuring that the Company's O&CA and Board procedures are followed, and for advising on suggested changes.

Leigh Fisher-Hoyle was appointed as Company Secretary in 2015. As Company Secretary her role is to provide legal and regulatory advice as required by the Board or any Director and is responsible for advising the Board through the Chairman on governance matters. The Board is kept informed of major changes to law and regulation affecting the Company's business. The Company Secretary also advises on Directors' duties and conflicts. All Directors are aware that any conflicts of interest must be reported to and registered with the Company Secretary.

GOVERNANCE REPORT (continued)

Board Meetings

The Board meets a minimum of six times a year at approximately bi-monthly intervals, which is considered sufficiently regularly to enable the Board to discharge its duties effectively. It may meet on such further occasions as may be required.

Board attendance in the financial year under review was as follows:

Board Attendance 2017-18			
Colin Skellett	6/6	James Rider	6/6
David Barclay	6/6	Francis Yeoh	5/6
Gillian Camm	6/6	Hann Yeoh	6/6
Mark Watts	6/6	Hong Yeoh	6/6
Huw Davies	6/6	Mark Yeoh	6/6
Fiona Reynolds	5/6	Andrew Pymer	6/6
Richard Keys	6/6		

Board Committees and Advisory Panels

Four formal committees operated throughout the financial year under review:

- Audit Committee
- Remuneration Committee
- Nominations Committee
- Corporate Responsibility Committee.

These Committees operate under the authority of the Board and assist the Board in carrying out its duties. The Committees report back to the Board on decisions and actions taken together with any specific recommendations. Reports from the Chair of each of the Committees are included in the Governance Report.

The Board also receives reports from two liaison panels and a customer partnership panel as part of the Company's commitment to wide stakeholder engagement.

The Futures Panel is chaired by Fiona Reynolds. It keeps under review emerging issues facing all companies today (including sustainability, health and the environment). By invitation a range of external scientific and technical expertise is brought to this panel.

The Wessex Water Partnership including our key organisational stakeholders, scrutinises and assesses the Company's delivery against customer related outcomes and performance commitment. The Partnership is independently chaired by Dan Rogerson who was previously Water Minister under the coalition Government.

The Catchment Panel helps to inform the Company's decision making about sustainable land and water resource use in the context of the Company's services, constructed and natural assets and entitlements. The panel includes representatives of the Environment Agency, Natural England, the Drinking Water Inspectorate, the National Farmers' Union and the Country Landowners Association. The panel is chaired by Dr Richard Cresswell.

Board, Committee and Director Performance

The Board has agreed to review its own performance, and the performance of its Committees, the Chairman, the Executive Directors and the Independent Non-Executive Directors, annually in accordance with the Code. Generally, the Board will engage the services of an external consultant at least one year in three. Between external evaluations, reviews are facilitated by the Company Secretary. Evaluation of the Board considers the Board's balance of skills, experience, independence and knowledge of the Company and how the Board works together as a unit, and other factors related to its effectiveness.

Several improvements were identified in the 2017 review. The Independent Non-Executive Directors now have a wider visibility of the Group's activities outside the regulated entity through the Independent Directors' performance committee that sits prior to each Company Board.

GOVERNANCE REPORT (continued)

A questionnaire was sent to relevant parties within Wessex and a series of structured interviews set up with internal stakeholders and external ones including OFWAT, EA and DWI. The results will be presented to Directors for discussion and action.

Directors' Remuneration

Details of Directors' remuneration are set out in the Remuneration Committee Report on page 34.

Directors' Interests and Conflicts

Directors are aware of the requirement to disclose interests in contracts with the Company and any conflicts of interest. No such interests or conflicts were disclosed during the year.

Whistleblowing

The Company has adopted and publicised to all its employees a whistleblowing policy for reporting instances of malpractice or inappropriate activity across all areas of business, including water regulation, health and safety, bribery, corruption and fraud. All reports are treated on a strictly confidential basis. Reports on whistleblowing are made to the Audit Committee and details are set out in the Audit Committee Report.

Anti-corruption

The Company has adopted a formal policy on business ethics. Directors and employees are expected to commit to the highest standards of professional and ethical conduct in order to protect the Company's reputation and standing. Bribery and corruption is not tolerated. All Directors and employees are made aware of the Company's policy and that breaching it will result in disciplinary action. No instances of a breach of the policy were recorded in the year.

Procurement

The Company has in place procurement rules that ensure awards of contracts for works, services and supplies are made after compliance with the Utilities Contracts Regulations 2006 and for contracts below the relevant thresholds in accordance with clear internal rules. The rules promote fair competition for potential suppliers. All relevant staff are required to certify to internal audit through the year that they have complied with the rules or to disclose non-compliance. No material instances of non-compliance were recorded during the year.

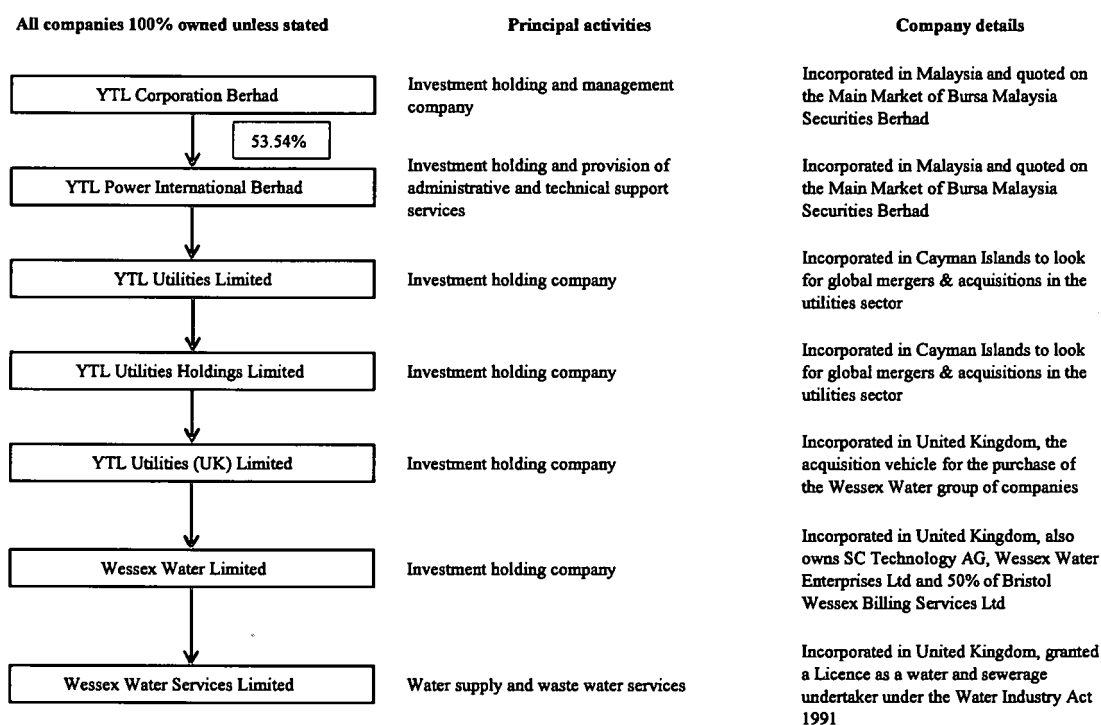
GOVERNANCE REPORT (continued)

Group Structure

Ofwat’s published document Board Leadership, Transparency and Governance – Holding Company Principles sets out the principles it expects the holding companies of a regulated water company to follow to demonstrate adherence to the highest standards of governance, particularly in its interaction with a regulated water company. The Holding Company Principles build upon and supplement the Company’s licence provisions dealing with its relationship with its owners.

The Company’s ultimate holding company is a Malaysian company YTL Corporation Berhad that is listed on the main market of Bursa Malaysia Securities Berhad. It addresses the Holdco Principles as described in the paragraphs below.

A diagrammatic representation of the Group’s structure appears below showing ownership of the regulated Company through to YTL Corporation Berhad and each company’s country of incorporation and role in the structure. YTL Corporation Berhad at 30 June 2017 was 51.24% owned by third party shareholders and 48.76% owned by Yeoh Tiong Lay & Sons Holdings Sdn Bhd.



The following Directors of the Company are also Directors of the Group companies above:

Colin Skellett, Mark Watts and Andrew Pymer are Directors of Wessex Water Ltd. Colin Skellett and Mark Watts are directors of YTL Utilities (UK) Ltd and YTL Utilities Holdings Ltd.

Francis Yeoh and Mark Yeoh are Directors of Wessex Water Ltd, YTL Utilities (UK) Ltd, YTL Utilities Ltd, YTL Power International Berhad and YTL Corporation Berhad. Hong Yeoh is a Director of Wessex Water Ltd, YTL Utilities (UK) Ltd, YTL Utilities Holdings Ltd, YTL Utilities Ltd, YTL Power International Berhad and YTL Corporation Berhad. Hann Yeoh is a Director of YTL Utilities Holdings Ltd.

YTL Corporation Berhad’s consolidated debt and equity are shown in its annual accounts available at its YTL Corporation website. The Company has no borrowings with other Group companies.

The Company operates independently. There are no matters specifically reserved to the shareholder. In practice the Board operates (and has operated continuously for more than a decade) without the requirement for shareholder resolutions. A list of those Directors of the Company who also hold office within the Group structure appears above. Disclosure of the interests of such Directors has been made to the Company.

Governance of YTL Corporation Berhad is in accordance with the requirements of Bursa Malaysia and corporate law in Malaysia which include a requirement to publish statements in its annual accounts on corporate governance, risk, risk management and internal control and the workings of its audit committee.

GOVERNANCE REPORT (continued)

YTL Corporation Berhad and YTL Power International Berhad gave undertakings to Ofwat in 2002 upon the acquisition of the Company that they and their subsidiaries would comply with the requirements of Licence Condition P. The Condition P undertaking provides that:

- they would give the Company all information as may be necessary to enable the Company to comply with the conditions of its appointments as a water and sewerage undertaker;
- to refrain from any action which would cause or may cause the company to breach any of its obligations under the Water Acts or the conditions of its Licence;
- to ensure that at all times the Company's Board contains not less than three Independent Non-Executive Directors.

YTL Corporation Berhad has confirmed that it:

- fully understands the duties and obligations of the Company arising under statute and its Licence;
- is aware of and is complying with the obligations of Condition P of its Licence;
- discharges these obligations by various means including through its knowledge of the terms of the Licence, the appointments of shareholder directors to the Board of the Company and their involvement in the affairs of the Company and the advice of its UK corporate lawyers;
- will provide the Company with the information it legitimately needs to assure itself that it is not at risk from activities elsewhere in the YTL Group;
- will identify and disclose to the Company promptly in writing any issues, if such should arise, within the YTL Group which may materially impact upon the Company for publication on the Company's website or disclosure in its annual report any relevant announcements made on Bursa Malaysia;
- will facilitate, so far as it is reasonably able, compliance with the Company's Code of Practice for Corporate Governance;
- will support the Company's decision making processes so that it can make strategic and sustainable decisions in the interests of the Company for the long term.

Audit Committee Report

All the independent non-executive directors of the Board as below were members of the Audit Committee throughout the financial year under review:

Huw Davies (Chair)

Gillian Camm

Fiona Reynolds

Richard Keys

The Board is satisfied that all members of the Audit Committee are independent and that through Huw Davies and Richard Keys, the Committee has relevant financial experience.

Role and Report on Activities

In accordance with Code Provision C.3.2. and C3.3., our Governance Arrangements are available on the Company's website and provide full terms of reference for the Audit Committee.

This report provides details of the role of the Audit Committee and the work it has undertaken during the financial year under review.

The members of the Audit Committee receive updates on financial reporting, the regulatory framework and performance throughout each financial year. In addition to the Committee members the following routinely attend the Committee meetings by invitation; the Director of Finance, the Managing Director of Wessex Water Services Limited, The Director of Regulation and Reform, Financial Controller, Head of Internal Audit, and the audit partner from the external auditor KPMG. Other senior management and the Company's external technical auditor are also invited to attend as appropriate. The technical editor for the Wessex Water Partnership is also invited to the Audit Committee meeting which considers the Annual Review and Performance Report.

Following each meeting the chair of the Audit Committee reports to the subsequent meeting of the Board on the Audit Committee's work.

GOVERNANCE REPORT (continued)

The Audit Committee met four times in the financial year under review, which it considered sufficient to enable it to discharge its duties effectively.

Audit committee attendance		Length of Committee Service
Huw Davies	4/4	4 years
Gillian Camm	4/4	7 years
Fiona Reynolds	3/4	6 years
Richard Keys	4/4	2 years

Its work focused on:

- overseeing the Company's financial reporting processes and accounting policies
- ensuring that the Company has adequate internal controls and that they are appropriately reviewed and implemented
- overseeing the internal and external audit programmes
- ensuring compliance with the regulatory reporting obligations of the Company, including the Risk and Compliance Statement and the Company's performance commitments.

In accordance with Code Provision C.3.8, key issues discussed during the financial year under review included:

- Detailed review of the Company's preparedness for the regulated business planning (PR19) process
- Continued assurance of the Open Water processes post sector retail non-household market opening
- Detailed review of the Company's Information Assurance Statement and Information Assurance
- Plan in accordance with Ofwat's Company Monitoring framework – final position and recommending their approval to the Board
- Company performance on a number of internal processes to deliver regulatory outputs and performance commitment data

In reviewing the financial statements the Audit Committee considered the content, accuracy and tone of the financial statements, the principal risks to the business on pages 19 to 20 of the Strategic Report and other financial disclosures prior to their release ensuring compliance to the Code Provision C1.1. and C3.4. that the Annual Report and Accounts present a fair, balanced and understandable position.

EY reported to the Audit Committee on their audit of the year-end financial statements.

Internal Controls

Topic	Activity
Internal Controls	<p>The Audit Committee, assisted by internal audit, monitors the effectiveness of the system of internal controls which have been in place for the year under review and up to the date of approval of the annual report and accounts. It also reviews management reports received from the external auditor.</p> <p>The Audit Committee receives reports on any whistleblowing allegations made to the Company from either internal or external sources, concerning fraud, bribery or other matters. Reports include the outcomes of resulting investigations and the management action taken. Where appropriate the Audit Committee is asked to approve the proposed management actions. Three anonymous whistleblowing allegations were received and investigated in the year. For the completed investigations no corroboration of the allegations has been found.</p>
Oversight of Internal Audit and External Audit	<p>The Audit Committee oversees the work of the Company's internal audit function, monitoring and reviewing the effectiveness of the internal audit activities, and manages the relationship with its external auditor. The Audit Committee reviews the performance of the internal and external auditor to ensure that they are effective. The Audit Committee regularly holds discussions at the end of its meetings with both the internal and external auditor in the absence of executive management.</p>

GOVERNANCE REPORT (continued)

<p>Internal Audit</p>	<p>The annual programme of planned internal audits is agreed by the Audit Committee prior to the start of each financial year based on a balance of topics which represent major business risks, and internal business processes which affect either financial or regulatory compliance. A total of 16 individual audit reports were submitted to the Committee in the year.</p> <p>At the request of either Executive Directors, senior managers or the Audit Committee, additional audits are undertaken throughout the financial year to address any issues that arise in the financial year.</p> <p>The Head of Group Internal Audit reports back on reviews of performance and the effectiveness of the Company’s internal controls and their adequacy in managing business risk and performance. This work is summarised and reported to the Audit Committee on a regular basis. The audit plans and the level of resources of the internal audit function are reviewed at least annually by the Audit Committee. The Head of Group Internal Audit is free to raise any issues with the Audit Committee or its Chairman at any time during the financial year.</p>
<p>External Auditor</p>	<p>EY were appointed as the Company’s auditor at the end of 2017. This has been retendered in accordance with the FRC code. KPMG Completed all required audit work up to December 2017.</p> <p>The audit partner attends by invitation meetings of the Committee, and the Committee monitors the effectiveness of the external auditor throughout the year taking into account their own experience of the auditor’s effectiveness in the year.</p> <p>KPMG was paid £159k for audit fees and a total of £27k for advice on tax and other matters in the 2016/17 financial year. EY were paid £159k for audit work in the 2017/18 financial year. The individual commissions for non-audit work were considered to have no impact on the auditor’s objectivity and independence. As a matter of policy, fees paid to the external auditor for non-audit services will not exceed 50% of the annual audit fee unless approved in advance by the Chair of the Audit Committee.</p> <p>EY reports to Ofwat in respect of the Company’s Annual Performance Report.</p> <p>As part of the assurance process for this Annual Review document the Audit Committee also receives a report from its technical auditor on non-financial regulatory performance information provided in the Annual Review including the performance commitment data. The technical auditor services were re-tendered in 2015-16 and a new technical auditor, Mott McDonald, was appointed for AMP6.</p>

Financial Reporting

Material issues considered by the Audit Committee in relation to the regulatory accounts (as also reported by the external auditor) were as follows:

<p>Topic</p>	<p>Activity,</p>
<p><i>Revenue Recognition</i></p>	<p>The Committee considered the key financial risk that can come from the estimation of the amount of unbilled income charges of the period. In this they discussed the management estimates and assumptions that are aligned to current accounting standards.</p>

GOVERNANCE REPORT (continued)

<i>Bad Debt Provision</i>	The Committee considered the key financial risk that arose due to the subjective nature of the provision. It reviewed the methodology of the provision in relation to the different components of the debt and the reasonableness of the differing provision made against each component.
<i>Pension Deficit</i>	The Committee considered the key financial risk that the assumptions made by the Company in association with the independent actuary, in arriving at the pension deficit under IAS 19, could lead to an overly prudent or aggressive position. In particular, the assumptions in relation to inflation, discount rate, pension and salary increases, return on equity and life expectancy were tested against the range of assumptions used by other companies.
<i>Classification of Capital Expenditure</i>	The Committee considered the key financial risk of the degree of judgement involved in the classification of expenditure between operating expenses and capital expenditure. In doing so they considered the level of capital expenditure, the Regulatory Accounting Guidelines and International Financial Reporting Standards, the recharges from overhead to capital projects and the controls of the Company.
<i>Taxation</i>	<p>The Committee also considered the amounts recorded for corporation tax and deferred taxation in the income statement and balance sheet. They reviewed the split between current and prior year taxation, the overall tax reconciliation and current taxation issues as highlighted by the external auditor.</p> <p>The Committee was satisfied that each of the above issues had been adequately explained and correctly recorded in the regulatory accounts of the Company.</p>
<i>Misstatements</i>	Management confirmed to the Audit Committee that they were no material misstatements or immaterial misstatements in the regulatory accounts to achieve a particular presentation. The external auditor reported to the Committee that in the course of their work no material misstatements had been found. The Committee was satisfied that the external auditor had fulfilled its responsibilities to the Audit Committee and the Company.

Oversight of Internal Audit and External Audit

The Audit Committee oversees the work of the Company's internal audit function, monitoring and reviewing the effectiveness of the internal audit activities, and manages the relationship with its external auditor. The Audit Committee reviews the performance of the internal and external auditor to ensure that they are effective.

The Audit Committee regularly holds discussions at the end of its meetings with both the internal and external auditor in the absence of executive management.

Internal Audit

The annual programme of planned internal audits is agreed by the Audit Committee prior to the start of each financial year based on a balance of topics which represent major business risks, and internal business processes which affect either financial or regulatory compliance. A total of 17 individual audit reports were submitted to the Committee in the year.

Nominations Committee Report

The following were members of the Nominations Committee throughout the financial year under review:

Francis Yeoh (Chair)
 David Barclay
 Gillian Camm
 Huw Davies
 Fiona Reynolds
 Richard Keys
 Colin Skellett
 Hong Yeoh

The Nominations Committee is chaired by a Non-Executive Director appointed by the shareholder, by way of exception to the relevant Code Provision. The relevant Code Provision envisages a majority of the members being Independent Non-Executive Directors and the Chairman or an Independent Non-Executive Director chairing the Committee. This is intended to ensure a formal, rigorous and transparent procedure for the appointment of new Directors to the Board in the case of a listed company with disparate shareholders. However, during the year the Company’s Nominations Committee complied with the Principles and spirit of the Code and its composition reflects the requirements of a private company with a sole shareholder.

Role and Report on Activities

The Nominations Committee’s full terms of reference are available on the Company’s website.

This report provides details of the role of the Nominations Committee and its work over the financial year under review.

The purpose of the Nominations Committee is to ensure that appropriate procedures are in place for the nomination, selection, training and evaluation of Directors. It reviews Board structure, size and composition.

The role of the Nominations Committee is to evaluate the balance of skills, experience, independence and knowledge on the Board.

The Nominations Committee met once during the financial year under review under the chair of Francis Yeoh. Its role includes monitoring the independence of Independent Non-Executive Directors, advising the Board on any conflicts of interest and reviewing executive succession planning.

Nominations committee attendance	
Francis Yeoh	1/1
Hong Yeoh	1/1
David Barclay	1/1
Gillian Camm	0/1
Huw Davies	1/1
Fiona Reynolds	1/1
Richard Keys	1/1
Colin Skellett	1/1

Corporate Responsibility Committee

The following were members of the Corporate Responsibility Committee throughout the financial year under review:

Gillian Camm (Chair)
 Fiona Reynolds
 Richard Keys

Chaired by an Independent Non-Executive Director, the principal purpose of this Committee established in 2013 is to make recommendations to the Board about the Company’s corporate and social obligations to its employees and other stakeholders. The Committee invited one current and one former executive director to the Company, Andrew Pymer and David Elliott to attend.

Role and Report on Activities

The Committee’s full terms of reference are available on the Company’s website.

Corporate responsibility is central to the values against which our business operates. The Company’s long-term success depends on meeting the values of our customers, employees and other stakeholders.

During the year the Committee commented on and reviewed progress on diversity including areas of current focus to improve diversity. The Committee reviewed the Company’s gender pay gap report and initiatives to over time, reduce the Company’s gender pay gap. At each meeting, the diversity metrics have been reviewed and challenged by the Committee. It is recognised that progress is being made to attract, develop and retain a more diverse workforce but that it takes time for initiatives to show progress.

The committee reviewed the Company’s apprentice strategy and the progress made during the year in developing the apprentice programme including the first Higher Level Apprenticeship cohort and 12% female apprentice intake in traditionally male dominated areas of water technicians, electrical, mechanical and construction. The success of apprenticeship open days was reported to the committee together with plans to maximise the drawdown on the apprenticeship levy introduced from April 2017.

The Committee reviewed a number of reports throughout the year including the use of the Corporate Hospitality Register, charitable giving, health and safety and the Gender Pay Gap reporting. Health and safety has been a key theme throughout the year and progress against the current five-year health and safety strategy. The Committee has reviewed progress in relation to occupational health and employee assistance service provision.

The Committee has reviewed the Company’s Sustainability Vision, environmental accounting approaches and catchment reporting, all of which are being amended to take account of our longer-term plans beyond 2020. The suggestions made by the Committee have been considered and will be reflected within these publications when produced later in 2017.

Corporate responsibility committee attendance	
Gillian Camm	2/2
Fiona Reynolds	2/2
Richard Keys	2/2

Remuneration Committee Report

The following were members of the Remuneration Committee throughout the financial year under review:

Hong Yeoh (Chair)
David Barclay
Gillian Camm
Huw Davies
Mark Yeoh
Richard Keys

The Remuneration Committee is chaired by a Non-Executive Director appointed by the shareholder, by way of exception to the relevant Code Provision. The relevant Code Provision envisages at least three Independent Non-Executive Directors on the Remuneration Committee. This is intended to ensure a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual Directors in the case of a listed company with disparate shareholders. However, the Company's Remuneration Committee complies with the Principles and spirit of the Code and reflects the requirements of a private company with a sole shareholder, resulting in a formal and transparent procedure for developing policy on executive remuneration.

Role and Report on Activities

The Remuneration Committee's full terms of reference are available on the Company's website.

The Remuneration Committee determines, on behalf of the Board, the Company's policy on the remuneration (including pension rights and any compensation payments) of Executive Directors, the Chairman and senior executive managers. The Committee seeks to link rewards to performance to promote the long-term success of the Company and does not reward poor performance.

This report sets out the remuneration policy for the Directors of Wessex Water and discloses the amounts paid to them in the financial year ended 30 June 2017. The policy also applies to the remuneration of the Company's senior managers.

The Remuneration Committee met twice during the financial year under review, which was considered sufficient to enable it to discharge its duties effectively.

The Remuneration Committee continued to monitor the Company's remuneration policy to take account of evolving best and market practice. The annual bonus plan is designed to promote the success of the Company over the five-year regulatory period, and is based on a portfolio of KPIs linked to the Company's performance scorecard and Ofwat's measures of success.

Salary and bonus levels were benchmarked against the Hay Group Industrial and Service, National Utilities and South West Utilities market sectors with jobs sized in relation to scope, role responsibilities and impact to determine salary. The Remuneration Committee continued to take a proactive approach to responding to developments in legislation, best practice and the wider market, as well as the corporate strategy, in order to ensure that the Company's senior executive reward policy remained market competitive and fit for purpose.

The Remuneration Committee addressed the need to ensure that changes in senior executive remuneration are proportionate in the context of workforce pay. While it has not set a specific policy on the relationship between Executive Directors' pay and that of the rest of the workforce, it aims to ensure that executive salary movement is appropriately aligned to the rest of the workforce and it specifically considers this aspect as part of its decision making process.

To ensure that the Company's remuneration practices are competitive but not excessive, the Remuneration Committee has access to detailed external research on market data and trends from experienced specialist consultants.

Recruitment of Executive Directors

The base salary for any new Executive Director takes into account market data for the relevant role, relativity with the salaries of existing Executive Directors, the individual's experience and current base salary. In the event that an individual is recruited at below market level, their base salary may be aligned over a period of time to the upper quartile position of the relevant market position subject to their performance in the role.

Individual Executive Directors participate in a senior manager bonus scheme, governed by the Remuneration Committee. Executive Directors have their target bonus set at 50% of base salary and their maximum bonus at 100% of which a proportion is withheld until 2020 under LTIP arrangements.

Remuneration Committee Report (continued)

During the year, the Remuneration Committee took advice from their independent advisers, Korn Ferry Hay Group. Korn Ferry Hay Group provided detailed market analysis and advice to the Committee for the senior management group, including Executive Directors and Non-Executive Directors. Korn Ferry Hay Group’s fee for providing such advice was £17,850 for the year. In line with best practice, the Committee assesses from time to time whether the appointment of its current independent remuneration advisers remains appropriate and whether the role should be put out to tender.

The Remuneration Committee also considers what compensation commitments (including pension contributions and all other elements) Directors’ terms of appointment would entail in the event of early termination. The aim is to avoid rewarding poor performance, and the Remuneration Committee would take a robust line on reducing compensation to reflect departing Directors’ obligations to mitigate loss.

The Group Chief Executive (Colin Skellett) and the Group Director of Human Resources (Mark Nicholson) attended the Remuneration Committee meetings to provide advice and respond to specific questions. They did not participate in any discussion concerning their own remuneration.

No new directors were appointed during the year.

Remuneration Committee Attendance	
David Barclay	2/2
Gillian Camm	1/2
Huw Davies	2/2
Richard Keys	2/2
Hong Yeoh	2/2
Mark Yeoh	2/2

The remuneration policy for senior executives is aligned to the Company’s four key focus areas, as shown below.

Key Focus	Remuneration Policy
Customer service delivery and business costs	Target annual bonus potential just below the median when compared to industrial and service and national utilities market, supported by competitive base salary at or below market upper quartile. Financial based KPIs within the annual bonus are set with close regard to Ofwat’s determination, ensuring that we closely manage our performance within the regulatory limits. Customer focused KPIs form a substantial part of the annual bonus scorecard.
Employee alignment	The Remuneration Committee aims to ensure that the executive salary movement is aligned to the rest of the workforce. The performance scorecard is used for the annual bonus throughout the Company. KPIs within the annual bonus for all employees include health and safety, engagement and training compliance factors.
Environment performance	KPIs within the annual bonus for all employees include environmental factors.
Financial performance	A variety of financial KPIs are used within the annual bonus plan with the aim of delivering a fair return to our shareholder.

Remuneration Committee Report (continued)

The Remuneration Committee continues to monitor variable pay arrangements for the Executive Directors and senior managers. The Remuneration Committee believes that the arrangements are appropriately managed and that the choice of performance measures and targets does not encourage undue risk taking by the executives so that the long-term performance of the business is not put at risk by considerations of short-term value. The arrangements incorporate a range of internal and external performance metrics, measuring both operational and financial performance providing a rounded assessment of overall company performance to ensure that a significant portion of executive remuneration is performance-related.

Policy for loss of office

There are no specific provisions for compensation on early termination (except for payment in lieu of accrued but untaken holidays) or loss of office due to a change of ownership of the Company. The Committee will review all contractual obligations and will seek legal advice as and when necessary on the Company's liability to pay compensation in such circumstances. The Committee will seek to reduce the level of compensation payable taking into account, amongst other factors, the Company's and the individual's performance, the Executive Director's obligation to mitigate loss, and length of service.

Early termination payments made in the year

No Executive Director left the Company during the year.

Relative importance of spend on pay

Note 5 to the accounts shows the total employment costs, excluding exceptional items, of the Company and the movement from last year.

	2017-18 £m	2016-17 £m	Movement £m	Movement %
Wages and salaries	90.1	81.4	+8.7	+10.7
Social security costs	9.5	8.5	+1.0	+11.8
Other pension costs*	13.5	12.1	+1.4	+11.6
Total employment costs*	113.1	102.0	+11.1	+10.9

Charged to:

Capital schemes	38.9	39.8	-0.9	-2.3
Operating costs*	74.2	62.2	+12.0	+19.3

The relative importance of total employment costs can be shown as:

Percentage of	2017-18* %	2016-17 %	Source
Turnover	20.9%	19.2%	Income statement
Profit before tax*	80.1%	64.6%	Income statement
Profit after tax*	97.6%	67.6%	Income statement
Dividends	128.5%	110.9%	Note 9
Capital expenditure	46.7%	52.6%	Cash flow statement

*Excluding exceptional pension credit of £35.9m

Remuneration Arrangements for Executive Directors 2017-18

The following table sets out the elements of the Company's Executive Directors' remuneration package:

- Basic salary

Remuneration Committee Report (continued)

- Bonus (non-pensionable) subject to individual and company performance
- Pension plan
- Company car
- Private fuel allowance
- Private health insurance and executive medical screening
- Share option scheme of a parent company YTL Power International Berhad.

The table below highlights the key elements of executive remuneration and the link to company strategy, how executive remuneration is operated in practice and the link to relevant performance metrics.

Element of Pay	Purpose and link to Company strategy
Base Salary	To attract and retain the high calibre Executive Directors and Senior Managers needed to implement the Company's strategy and maintain its leading position in the industry. To provide a competitive salary relative to comparable companies in terms of size and complexity.
Taxable Benefits	To attract and retain high calibre Executive Directors and Senior Managers and to remain competitive in the market.
Pension	To attract and retain high calibre Executive Directors and Senior Managers and to remain competitive in the market.
Annual Bonus	To motivate and reward Executive Directors and Senior Managers for the achievement of demanding financial objectives and key strategic measures (including measures of customer satisfaction, service quality and environmental performance) over the financial year and five year regulatory period. The performance measures set are stretching in the context of the nature, risk and profile of the Company.
LTIP	To motivate and reward Executive Directors for the achievement of demanding financial objectives and key strategic measures (including measures of customer satisfaction, service quality and environmental performance) over the five year regulatory period to promote the long term success of the Company.
How operated in practice	
Base Salary	Reviewed annually and takes effect from 1 April. Review takes into consideration; <ul style="list-style-type: none"> • Individual responsibilities, experience and performance • Salary levels for similar sized roles in utilities and south west industrial and service markets • The level of pay increases awarded across the Company • Economic and market conditions • The performance of the Company Salaries are paid monthly.
Taxable Benefits	Benefits include: <ul style="list-style-type: none"> • Company car • Private medical insurance • Executive health screening • Private fuel allowance
Pension	All Executive Directors participate in the Company's defined benefit pension scheme. Executive Directors are also insured for a lump sum of up to four times their pensionable salary on death in service.

Remuneration Committee Report (continued)

<p>Annual Bonus and Long-term Incentive Plan</p>	<p>The Board of Directors sets annual performance targets for the Company prior to the commencement of each new financial year. Company and individual performance against those targets is measured at the end of the financial year and the level of bonus payable is calculated at that point. Bonuses are paid in April. From 1 April 2015 the remuneration Committee established a Long Term Incentive Plan for Executive Directors whereby 20% of any above target bonus element earned will be held back for payment at the end of AMP6 in 2020. The Company will match the value of the retained bonus payment, up to 100%. The long-term incentive payment will be paid to Directors in April 2020. The Committee has the discretion to and does consider the effect of corporate performance on environmental and governance risks when reviewing Executive Director and senior management bonuses to ensure variable remuneration incentivises and rewards appropriate behaviour. Part of the bonus may be forfeited for under performance in respect of customer service, environmental, regulation and employee related performance targets.</p> <p>Annual bonus is not pensionable.</p>
<p>Maximum opportunity</p>	
<p>Base Salary</p>	<p>There is no prescribed maximum increase. However, Executive Director salary increases are aligned to the increases provided to all Company employees. Such increases are negotiated by the joint staff council involving management and trade union representatives.</p>
<p>Taxable Benefits</p>	<p>N/A</p>
<p>Pension</p>	<p>18.2% of base salary (21.7% from 1 April 2018)</p>
<p>Annual Bonus</p>	<p>Maximum bonus opportunity is 100% of base salary.</p>
<p>Description of performance metrics</p>	
<p>Base Salary</p>	<p>N/A</p>
<p>Taxable Benefits</p>	<p>N/A</p>
<p>Pension</p>	<p>N/A</p>
<p>Annual Bonus</p>	<p>A combination of 29 key performance indicators relating to financial, customer, environment & assets and employee related measures and targets. An equal weighting is applied to each of the four categories. The committee has absolute discretion in making bonus payments.</p>
<p>Change to policy</p>	
<p>Base Salary</p>	<p>No change</p>
<p>Taxable Benefits</p>	<p>No change</p>
<p>Pension</p>	<p>No change</p>
<p>Annual Bonus</p>	<p>No change</p>

Remuneration Committee Report (continued)

A detailed explanation of each of these follows and the table below highlights some of the elements.

Component 2016/17	Colin Skellett Group Chief Executive	Mark Watts FD	Andrew Pymmer MD	James Rider COO
Target bonus (% of salary)	50	50	50	50
Maximum bonus (% of salary)	100	100	100	100
Actual bonus paid (% of salary)	63	67	56	57
Actual bonus held as LTIP (% of salary)	3	4	2	2
Share options (maximum)	Approved 87,000 Unapproved 1,913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 213,000
Pension arrangement	Defined benefit - Pension in payment	Defined benefit	Defined benefit - Pension deferred	Defined benefit
Benefits	See below	See below	See below	See below

Benefits were company car based on list price and CO2 emissions, fuel £4,310, private medical insurance £1,784 (family).

Base Salaries and Benefits

Executive Directors' remuneration is reviewed annually by the Remuneration Committee and takes effect from 1 April. Salaries are set with reference to individual performance, experience and contribution, together with development in the relevant employment market (having regard to the upper quartile position for high performers in similar roles in the relevant employment market) and internal relativities.

Differences between Executive Directors' and Employees' Remuneration

The following differences exist between the Company's policy for the remuneration of Executive Directors and its policy for the remuneration of employees:

- Executive Directors pay is benchmarked against the upper quartile position of the South West Utilities market whilst we benchmark median pay and benefits against the South West Industrial and Service market for all fully qualified and experienced employees
- Executive Directors (and senior managers) participate in a bonus scheme that is not available to other employees to motivate and reward them for achievement of demanding financial objectives and key strategic measures.

In general, these differences arise from the development of remuneration arrangements that are market competitive for the various categories of staff ranging from employees to Executive Directors.

The Remuneration Committee gives due consideration to the current economic climate and current market practice regarding executive salary reviews and the broader employee salary review policy at the Company.

We do not normally link pay levels to company performance measures, as this is done where appropriate through the bonus arrangements.

The Remuneration Committee has reviewed 2017-18 salaries and has determined that salaries for Executive Directors will be increased from 1 April 2018 by 2% which is below the RPI increase of 3.9% awarded to employees across the Company.

Remuneration Committee Report (continued)**Executive Directors' Bonuses****2017-18 Scheme**

The annual bonus of Executive Directors is performance-related and designed to promote the long-term success of the Company. It is dependent on the achievement of Company and individual targets. Bonus disclosed is in relation to the performance in the year and is paid in April following the regulatory year-end.

The Company targets are 29 key performance indicators covering financial measures, customer service, environmental and asset measures and employee matters, as shown below.

Customers – Service Incentive Mechanism combined score / customers rating service good or very good / compliance with drinking water standards / customer contacts about drinking water quality / volume of water saved through water efficiency / properties suffering supply interruptions > 3 hours / volume of water leaked / restrictions on water use / internal flooding incidents per 10,000 properties / overall risk of flooding risk score.

Environment and Assets – EA's Environmental Performance Assessment / bathing waters passing EU standards / Biodiversity Action Plan landholding assessed and managed / greenhouse gas emissions / proportion of electricity self-generated / all regulatory outputs met / compliance with abstraction licences / monitoring of CSO's presenting a risk to the environment / river water quality improved.

Employees – H&S plan and accident statistics progress as assessed by the Corporate Responsibility Committee / employee rating company as a good employer / compliance with training plan / staff turnover / diversity plan progress as assessed by Corporate Responsibility Committee.

Financial – profit after corporation tax / operational costs / net capital expenditure / cash flow before dividends / dividends declared.

The target bonus for the Executive Directors was calculated as follows:

Target Bonus 2017-18	Colin Skellett CEO	Mark Watts FD	Andrew Pymmer MD	James Rider COO
Customer				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	29,290	20,372	30,600	21,700
Environment and Assets				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	29,290	20,372	30,600	21,700
Employees				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	29,289	20,373	30,600	21,700
Financial				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	29,290	20,372	30,600	21,700
Individual				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	29,289	20,373	30,600	21,700
Total				
% of salary	50%	50%	50%	50%
Amount £	146,448	101,862	153,000	108,500

In the financial year under review, 27 of the 29 Company targets were achieved or bettered.

There were two marginal target failures, two bathing waters did not pass EU standards and minutes lost through supply interruptions was 13.3 minutes compared with the target of 12.0 minutes. One of the bathing water failures was due to agricultural run-off rather than a Company process failure. Initiatives are being implemented to improve the minutes lost through supply interruptions.

The actual bonus payments are shown in the Directors' Emoluments table. The detail of how these bonus payments were calculated is shown below.

Remuneration Committee Report (continued)

Actual Bonus 2017/18	Colin Skellett CEO	Mark Watts FD	Andrew Pymmer MD	James Rider COO
Financial				
% of salary	11.8%	13.0%	10.2%	10.1%
Amount £	31,807	25,326	31,400	21,940
Customer				
% of salary	11.8%	13.0%	10.2%	10.1%
Amount £	31,807	25,326	31,400	21,940
Environment and Assets				
% of salary	11.9%	13.0%	10.3%	10.1%
Amount £	31,807	25,326	31,400	21,940
Employees				
% of salary	11.9%	13.1%	10.3%	10.1%
Amount £	31,808	25,326	31,400	21,940
Individual				
% of salary	11.9%	13.1%	10.3%	10.2%
Amount £	31,808	25,326	31,400	21,940
Total				
% of salary	59.3%	65.2%	51.3%	50.6%
Amount £	159,037	126,630	157,000	109,700

Annual bonus payments to Executive Directors are not pensionable.

Pensions

Executive Directors are members of the Wessex Water defined benefit pension scheme.

The scheme is a HMRC registered defined benefit occupational pension scheme. The Executive Directors are members of the WPS section, which provides:

- A normal retirement age of 65 years
- A pension at normal retirement age based on 1/60th of completed pensionable service and final pensionable salary
- Life cover of four times basic salary
- A pension payable in the event of retirement on grounds of ill health
- A dependant's pension on death of two thirds of the member's pension
- Guaranteed increases in line with price inflation (subject to a maximum of 5% each year).

Members' contributions are payable at the rate of 8% of basic salary, with the Company making a further 18.2% contribution (21.7% from 1 April 2018). Early payment of pension is available from age 55 with the consent of the Company. Any pension would be subject to a reduction, based on rates the trustees consider appropriate, acting on actuarial advice, to reflect the expected longer payment of the pension. No additional pension will become receivable by a Director if that Director retires early.

In the event of incapacity, an unreduced pension is payable immediately. Incapacity pensions can be paid on either a "partial" or "full ill health" basis depending on the conditions met. A full ill health pension is topped up to give additional service to age 65, subject to a maximum of 20 years.

Under the Trust Deed and Rules, pensions in payment in excess of any guaranteed minimum pension are guaranteed to increase in line with price inflation subject to a maximum of 5% each year. In the calculation of individual cash equivalent transfer values, allowance is made for such increases.

As a result of the changes in pension legislation for high earners, Wessex Water has introduced the following options for individuals under age 55 who are affected by the tax changes:

- continue in the scheme, with individuals meeting any tax liabilities as they fall due; or

Remuneration Committee Report (continued)

- continue in the scheme with a capped pensionable salary which restricts pension growth to the annual allowance limit (£50,000 pa) and receive a cash supplement in lieu of pension entitlement on the excess salary. The cash supplement is based on the employer contribution rate to the scheme, currently 18.2%.

Executive Directors' Service Contracts

All Executive Directors' service contracts are terminable by either the Company or the Executive Director providing 12 months' notice. There is a theoretical maximum payment in case of redundancy of 100% of salary inclusive of allowances and benefits plus their redundancy entitlement. There are no specific contractual payments or benefits which would be triggered in the event of a change in control of the Company.

Executive Directors	Date of current agreement	Date of appointment as Executive Director	Notice Period
Colin Skellett	01/04/2014	01/09/1989	12 months
Mark Watts	01/04/2014	16/03/2010	12 months
Andrew Pymmer	21/07/2016	01/08/2016	12 months
James Rider	21/07/2016	01/08/2016	12 months

Executive Directors' service contracts are available for inspection during normal office hours at the registered office, Wessex Water, Claverton Down Road, Bath BA2 7WW.

The Remuneration Committee will continue to review the contractual terms for Executive Directors to ensure they reflect best practice and are compliant with employment law.

None of the Executive Directors served as a Non-Executive Director for another company.

Non-Executive Directors

The remuneration policy for Independent Non-Executive Directors is determined by the Board. The remuneration reflects the time commitment and responsibilities of the role.

The breakdown of the Independent Non-Executive Directors' fees from 1 June 2017 is shown in the Directors' Emoluments table below. Independent Non-Executive Directors do not participate in share or bonus schemes or any other performance-related scheme, nor is any pension provision made.

Independent Non-Executive Directors are normally appointed for three-year terms (subject to statutory provisions relating to the removal of a Director) that may be renewed. They do not have service contracts but their terms of engagement are regulated by letters of appointment (copies of which are available on the Company's website).

Any term beyond six years for an Independent Non-Executive Director is subject to particularly rigorous review and takes into account the need for progressive refreshing of the Board balanced against the requirement for skills, experience, independence and knowledge.

Non-Executive Directors appointed by the shareholder do not receive any fees or other payments from the Company.

Remuneration Committee Report (continued)*Directors' Emoluments*

The table below shows the emoluments for the current year.

The auditor is required to report on the information in the following tables for 2017-18.

2017-18	Salary £000	Bonus £000	LTIP £000	Benefits £000	Pension contributions £000	Total £000
David Barclay	60	-	-	-	-	60
Gillian Camm	89	-	-	-	-	89
Huw Davies	83	-	-	-	-	83
Richard Keys	69	-	-	-	-	69
Andrew Pymer	308	157	1	18	59	542
Fiona Reynolds	71	-	-	-	-	71
James Rider	218	110	-	23	42	393
Colin Skellett	272	159	6	19	-	456
Mark Watts	187	121	7	19	-	333
Total £000	1,357	547	14	79	101	2,096

1. No emoluments earned by Francis Yeoh, Hann Yeoh, Hong Yeoh, Mark Yeoh or Kathleen Chew.
2. Benefits comprise private medical insurance, company car and fuel benefits.
3. Employer pension contributions may be received as payment into the Company pension scheme or as a cash benefit.
4. Three Directors received emoluments for services to other Group Companies, Colin Skellett £473k, Mark Watts £461k and David Barclay £15k. The Audit Committee was satisfied that services provided to other Group Companies do not reduce the effectiveness of the Directors' provision of services to the Company.

The table below shows the emoluments for the prior year.

2016-17	Salary £000	Bonus £000	LTIP £000	Benefits £000	Pension contributions £000	Total £000
David Barclay	85	-	-	-	-	85
Gillian Camm	84	-	-	-	-	84
Huw Davies	80	-	-	-	-	80
Richard Keys	66	-	-	-	-	66
Andrew Pymer	257	124	4	16	47	448
Fiona Reynolds	68	-	-	-	-	68
James Rider	194	107	3	21	35	360
Colin Skellett	266	168	9	19	-	462
Mark Watts	189	126	8	17	26	366
Total £000	1,289	525	24	73	108	2,019

Remuneration Committee Report (continued)

Chief Executive

No remuneration was paid to the Chairman (2017 – Enil). The total remuneration for the Chief Executive (Colin Skellett) was:

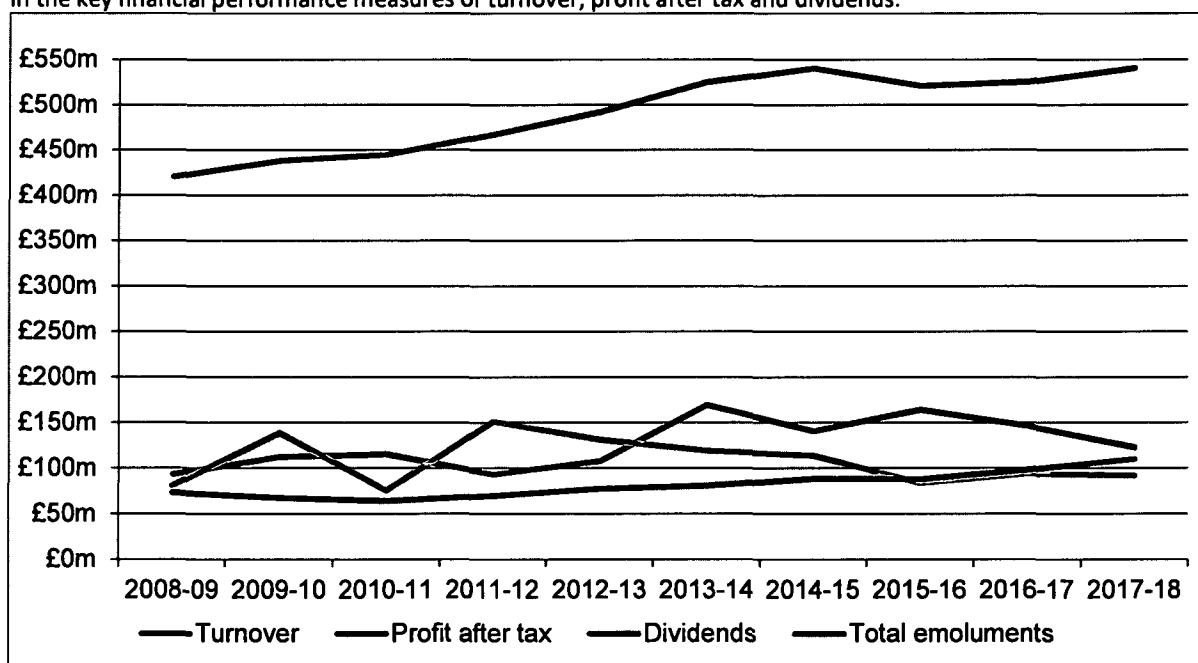
	Remuneration 2017-18 £000	Remuneration 2016-17 £000	% change
WWSL			
Salary	272	266	+2.3%
Bonus	159	168	-5.4%
LTIP	6	11	+45.5%
Benefits	19	25	-24.0%
Other group companies			
Salary	181	178	+1.7%
Bonus	276	252	+9.5%
LTIP	4	6	-33.3%
Benefits	13	13	+0.0%
Total	930	919	+1.2%
All employees WWSL			
Wages and salaries	90,100	81,100	+11.1%
Social security costs	9,500	8,500	+11.8%
Other pension costs (17-18 excluding exceptional credit of £35.9m)	13,500	12,400	+8.9%
Total	113,100	102,000	+10.9%

Comparison with remuneration increase for all employees:

The pay increase awarded to the employees of the Company on 1 April 2017, for the year 2017-18, was a 2.0% increase over the preceding year. On 1 April 2018 and increase of 3.9% was awarded for the year 2018-19.

Remuneration Link to Performance

The table below compares the movement over ten years in total emoluments of the Company with the movement in the key financial performance measures of turnover, profit after tax and dividends.



Dividends are as declared in the year. Total emoluments include Director's emoluments.

Remuneration Committee Report (continued)**Executive Directors' Defined Benefit Pension Provision**

	Pension service completed in years (1)	Normal retirement date at 65	Accrued pension at 30/6/2017 £pa	Increase in accrued pension during the year £pa	Accrued pension at 30/6/2018 £pa
Colin Skellett (2)	41	(2)	171,252	4,224	175,476
Mark Watts (3)	28	19/9/2026	129,964	(59,964)	70,000
Andrew Pymer	23	(4)	61,861	1,557	63,418
James Rider	33	7/4/2030	68,313	5,235	73,548

- (1) Including transfers in and bonus years
(2) Pension in payment
(3) Opted out and pension into payment April 2017
(4) Deferred pension

Executive Directors' Share Interests*Share Options*

YTL Power International Berhad (a parent company and itself a subsidiary of YTL Corporation Berhad) operates a share option scheme under which options are granted to employees of the Company. The terms of the scheme are specified under the YTL Power ESOS (2011 UK part) known as the "2011 UK Plan".

The majority of options are issued under terms approved by HMRC (the "Approved" scheme) but some are issued to senior employees under an "Unapproved" scheme. The options are for ordinary shares in YTL Power International Berhad of Malaysian Ringgit RM0.50 each.

The Executive Directors have been granted ordinary share options of Malaysian Ringgit RM0.50 each in YTL Power International Berhad under the 2011 UK Plan. The exercise of share options granted is not subject to any performance criteria, other than continued employment within the group.

Share options held by Executive Directors at the start and end of the financial year, and the exercise price of those share options are shown in the table below:

	Opening number 31/6/2017	Exercise price RM	Date of grant	Exercise date	Expiry date	Closing number 30/6/2018
Colin Skellett	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
Colin Skellett	1,913,000	1.38	1/6/2012	1/6/2015	31/3/2021	1,913,000
Mark Watts	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
Mark Watts	913,000	1.38	1/6/2012	1/6/2015	31/3/2021	913,000
Andrew Pymer	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
Andrew Pymer	913,000	1.38	1/6/2012	1/6/2015	31/3/2021	913,000
James Rider	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
James Rider	213,000	1.38	1/6/2012	1/6/2015	31/3/2021	213,000

Approved options were granted at an exercise price of RM1.65. Unapproved options were granted at an exercise price of RM1.49, which was adjusted to RM1.41 following the distribution to all shareholders of one share for every 20 ordinary shares held as at 13 March 2014, and to RM1.38 following the distribution to all shareholders of one share for every 50 ordinary shares held in 2017.

The share price at 30 June 2018 was RM1.03 or £0.19

Remuneration Committee Report (continued)**Shares Held**

There are no shares held by the Directors in the Company or the UK parent company. The Executive Directors held the following ordinary shares of Malaysian Ringgit RM0.50 each in YTL Power International Berhad (a parent company), at the start and end of the accounting period.

	Opening number 30/6/2017	Closing number 30/6/2018
Mark Watts	388,030	388,030
Andrew Pymer	53,815	53,815

The share price at 30 June 2018 was RM1.03 or £0.19

Remuneration Arrangements for Executive Directors 2018-19

Component	Colin Skellett CEO	Mark Watts FD	Andrew Pymer MD	James Rider COO
Target bonus (% of salary)	50	50	50	50
Maximum bonus (1) (% of salary)	100	100	100	100
Share options (maximum)	Approved 87,000 Unapproved 1,913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 213,000
Pension arrangement	Defined benefit - Pension in payment	Defined benefit - Pension in payment	Defined benefit - Pension deferred	Defined benefit
Taxable Benefits	Company car, fuel and private medical insurance			

(1) Of which a proportion is withheld until 2020 under LTIP arrangements

Bonus scheme 2018-19

For 2018-19 there are 29 performance indicators set to reflect the corporate targets in the current regulatory period, as shown below:

Financial – profit after corporation tax / operational costs / net capital expenditure / cash flow before dividends / dividends declared.

Customers – Service Incentive Mechanism service score / customers rating service good or very good / compliance with drinking water standards / customer contacts about drinking water quality / volume of water saved through water efficiency / properties suffering supply interruptions > 3 hours / volume of water leaked / restrictions on water use / internal flooding incidents per 10,000 properties / overall risk of flooding grid score.

Environment and Assets – EA's Environmental Performance Assessment / bathing waters passing EU standards / Biodiversity Action Plan landholding assessed and managed / greenhouse gas emissions / proportion of electricity self-generated / all regulatory outputs met / compliance with abstraction licences / monitoring of CSO's presenting a risk to the environment / river water quality improved.

Employees – H&S plan and accident statistics progress as assessed by Corporate Responsibility Committee / employee rating company as a good employer / compliance with training plan / staff turnover / diversity plan progress as assessed by Corporate Responsibility Committee.

Target Bonus 2018-19	Colin Skellett CEO	Mark Watts FD	Andrew Pymer MD	James Rider COO
Financial				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,600	19,832	31,200	22,100
Customer				
% of salary	10.0%	10.0%	10.0%	10.0%

Remuneration Committee Report (continued)

Amount £	27,600	19,832	31,200	22,100
Environment and Assets				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,600	19,832	31,200	22,100
Employees				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,600	19,832	31,200	22,100
Individual				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,600	19,832	31,200	22,100
Total				
% of salary	50%	50%	50%	50%
Amount £	138,000	99,160	156,000	110,500

Long term incentive scheme from 1 April 2015

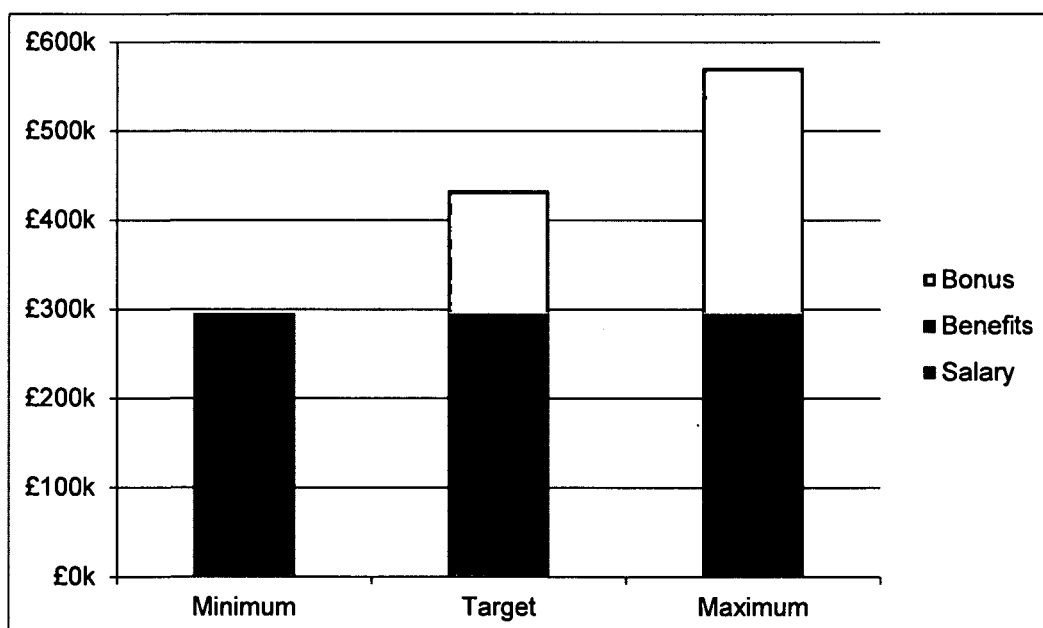
The Remuneration Committee approved the establishment of a long-term incentive plan (LTIP) for Directors whereby 20% of any above target bonus element earned will be held back for payment at the end of AMP6 in 2020. The Company will match the value of the retained bonus payment, up to 100%. The LTIP will be paid to Directors in April 2020.

Amounts of bonus held back from Executive Directors under the LTIP scheme were as follows:

Bonus held back as LTIP	Colin Skellett CEO	Mark Watts FD	Andrew Pymmer MD	James Rider COO
2015/16	£10,608	£8,000	-	-
2016/17	£9,634	£8,430	£2,667	£2,445
2017/18	£5,963	£7,370	£1,000	£300
Total	£26,205	£23,800	£3,667	£2,745

Illustrations of Remuneration Policy

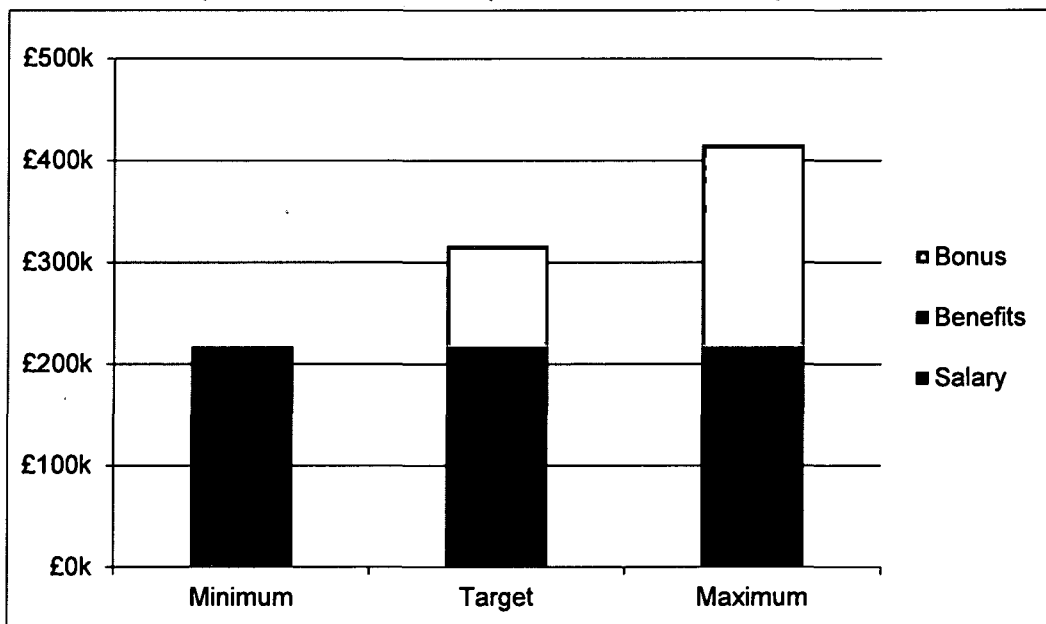
A) Colin Skellett - CEO (using estimated 2018-19 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned. No employer pension contributions.

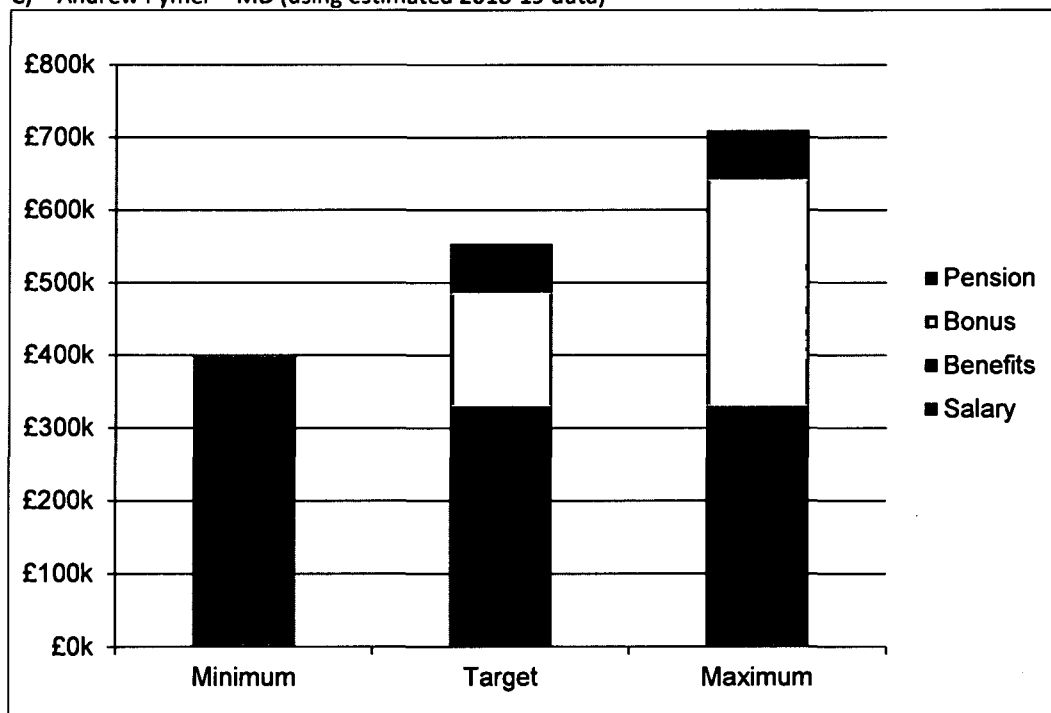
Remuneration Committee Report (continued)

B) Mark Watts – FD (using estimated 2018-19 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned. No employer pension contributions.

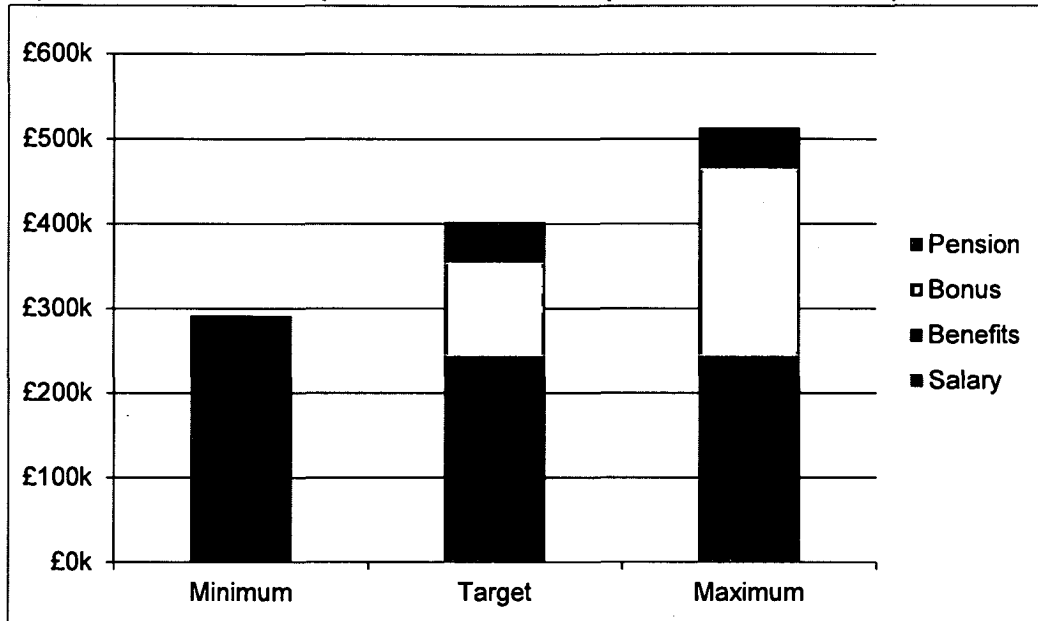
C) Andrew Pymer – MD (using estimated 2018-19 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned.

Remuneration Committee Report (continued)

D) James Rider – COO (using estimated 2018-19 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned.

Directors' Report

The Directors have pleasure in presenting their report and the audited statutory accounts (subsequently referred to as accounts) for the year to 30 June 2018.

The Directors consider the annual report and financial statements taken as a whole, to be fair, balanced and understandable and it provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Principal Activities

The main activities of the Company are the supply of water and the treatment and disposal of waste water.

In December 2014 the industry regulator Ofwat announced the final price control determination for the five-year period to March 2020. The price control for this period has been extended from one price control to four price controls covering wholesale water, wholesale waste water, household retail and non-household retail. The Directors accepted the price review for the next five years.

On 1 April 2017 all non-household customers were able to choose their retailer for water services. From that date the Company continued to offer wholesale services to those customers, but retail services were offered through Water2Business Ltd a joint venture between Wessex Water Ltd and Bristol Water Holdings Ltd.

Going concern

The Directors have considered the financial position of the Company and have concluded that they will be able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least 12 months from the date of approval of these accounts. Therefore the directors have prepared the accounts on a going concern basis.

Sustainability

Wessex Water Services Ltd has a sustainability vision that guides our progress towards being a sustainable water company. The sustainability vision is reviewed bi-annually.

Ethical Policy

We are determined to maintain our reputation as a Company that observes the highest standards of personal and corporate integrity by adhering to a strict code of business ethics. We aim to be the best and value everyone's contribution in our pursuit of excellence. We are honest in the way we conduct our business. We treat one another, our customers and the environment with respect.

Our People

It takes great people and great teamwork to provide water and sewerage services to nearly three million customers, 24 hours a day, seven days a week. That's why we encourage and reward our employees for their contribution to achieving our aims. We seek their ideas and put them into practice, celebrate success at our annual awards and encourage them to go the extra mile with our GEM scheme. This year we launched our People Programme, a dedicated programme of initiatives to address current and future strategic people priorities in areas including resourcing, talent management, reward and recognition, future working, diversity and employee wellbeing.

Our apprenticeship strategy is proving successful for both the Company and the local community, offering secure employment opportunities across our region.

Employment

Wessex Water Services Ltd is an equal opportunities employer. No person or group of persons applying for a job with the Company is treated less favourably than any other person or groups of persons because of their gender, race, class, colour, nationality, ethnic origin, marital status, sexual orientation, age, trade union membership or activity, religious belief or physical or mental disability.

Selection procedures and criteria ensure that individuals are selected and promoted on the basis of their relevant merits and abilities. These procedures are monitored and regularly reviewed. Where necessary, the Company provides staff with ongoing professional development to enable them to compete or qualify for positions, or to progress, within the Company.

Directors' Report (continued)

The Modern Slavery Act 2015

Wessex Water is committed to meeting the aims of the Modern Slavery Act 2015. We strongly oppose slavery and human trafficking in our supply chains and in any part of our business. To be trusted to do the right thing is one of our core values. We would never knowingly engage with suppliers or contractors involved in slavery or human trafficking. In accordance with the requirements of the Act we have published on our website a Slavery and Human Trafficking Statement 2018.

Environmental Policy

Wessex Water Services Ltd protects conserves and improves the environment and operates in a socially responsible manner. Working practices are continually revised as improved techniques and technologies become available. The environment policy is reviewed annually.

Research and Development

The Company carried out research and development in support of existing activities to improve the reliability and effectiveness of water and waste water services.

Market Value of Land and Buildings

In the opinion of the Directors, the market value of land and buildings of the Company exceeds the book value of these assets at 30 June 2018.

Charitable and Political Donations

£330,910 was donated to UK charities (2017 – £337,615) of which £224,690 (2017 – £245,230) was donated to local debt advice agencies to help provide debt and financial advice to customers in our area who are struggling to pay their water bills. No political donations were made in either year.

Other information

An indication of likely future developments in the business and particulars of significant events which have occurred since the end of the financial year have been included in the Strategic Report on pages 2 to 21. Information on the use of financial instruments by the Company are shown in note 22 to the financial statements.

Viability Statement

The Directors are required to assess the viability of the Company over a longer period than the 12 months required by a Going Concern statement.

The Directors have determined that currently a seven-year period to 31 March 2025 is an appropriate period over which to provide its Viability Statement. During the course of this year the Directors have been considering in detail a business plan and associated financial projections up to the end of March 2025. This plan will be submitted to the Water Services Regulation Authority (Ofwat) in September 2018.

The Directors have reviewed the principal risks contained in the Annual Review Summary. They have taken into account the current financial position of the Company, its cash deposits and available funds.

The regulatory model under which the Company operates gives a level of certainty over turnover up to March 2020 subject to assumption on RPI in November 2018. There is a large capital expenditure programme over the next two years, of a similar nature to that delivered in previous regulatory control periods, allowing the Directors to be able to predict the cost of construction with some certainty. The borrowing facilities in place are long term and maturing after 31 March 2020 with the exception of one £140m loan. The mix of borrowings is spread between fixed, floating and index linked. Interest rates are at a historically low and stable level and predictions of future increases are moderate.

The key areas considered by the Directors were:

- the liquidity of the Company over the next two years, and the probability that the Company will be able to replace the £140m loan with another borrowing facility
- compliance with financial covenants in respect of gearing and interest cover
- the impact of a higher than expected accounting pension deficit

Taking the Company risk register into account, plus the regulatory environment, the impact of the wider Group and the wider economic situation and outlook, the Directors considered the impact of individual risks. They also considered a series of scenarios linking back to one or more risks that would place financial stress on the company.

Directors' Report (continued)

These are:

Scenario considered	Link to Principal risk
The potential immediate and follow-on consequences of extreme weather conditions, such as higher expenditure, lower revenues and regulatory fines	Regulatory action, severe pollution incident
The potential immediate and follow-on consequences of a catastrophic service failure	Outcome delivery incentive failure, unfit water, information management
Macroeconomic shock (including lower productivity, lower demand, lower inflation, higher energy and construction costs, higher finance costs)	Availability of new finance

The scenarios above are hypothetical and severe for the purpose of creating outcomes that have the ability to threaten the viability of the Company; however, multiple control measures are in place to mitigate or prevent any impacts. If these scenarios arise various options are available to the Company in order to maintain liquidity so as to continue in operation. These include reducing any non-essential capital expenditure on projects, as well as not paying dividends. The results of the above stress testing showed that the Company would be able to withstand the impact of these scenarios occurring up to March 2020. The Directors therefore confirm that they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due up to 31 March 2020.

The Directors have also considered the subsequent period from April 2020 to March 2025. Ofwat has a statutory duty to finance the proper carrying out of the Company's functions, in particular by enabling the Company to secure a reasonable return on its capital. The Directors have assumed in this further analysis that Ofwat performs its statutory duty appropriately and understand that were that not to be the case an appeal could be made to the Competition and Markets Authority in early 2020.

The regulatory model also allows for turnover to be adjusted upwards in the event of a substantial adverse effect on the financial position of the Company, where this effect would not have been avoided by prudent management action. It also allows for turnover to be adjusted where a new legal obligation imposed on the Company as a water and sewerage undertaker has led to a material increase in the costs incurred.

In addition to the scenarios run above, the Directors have considered some additional scenarios that take into account longer term risks against the regulatory framework that will be in place as published in Ofwat's price review methodology.

Scenario	Details
Inflation sustained at a low level for five years	Inflation 2% lower than the Bank of England central forecast
Sustained high costs of new debt finance for five years	2% higher than central forecast
Sustained overspend	Sustained 15% overspend
A sustained increase in bad debt	20% increase
Regulatory enforcement action	Fines of 3% of turnover in one year
Combined service failures and overspend	Sustained overspends of 10%, sustained service failure penalties of 1.5% regulated equity and a regulatory fine of 1% of turnover

Again, the scenarios above are hypothetical and severe for the purpose of creating outcomes that have the ability to threaten the viability of the Company; however, multiple control measures are in place to mitigate or prevent any impacts.

In making its assessment of financial viability over this extended time period the Directors primarily considered the ability of the company to retain credit metrics consistent with an investment grade credit rating and found that in almost all cases this was possible post mitigation.

The Directors noted that in a small number of instances not all metrics are held above a level that is required to maintain an investment grade rating, even with the most available mitigating actions having been taken.

Directors' Report (continued)

Where this is the case the Directors considered the circumstances that would give rise to these modelled scenarios more deeply.

Having done so the Directors considered that in some scenarios the impact can be shown to be short-lived and would not reflect the underlying viability of the Company.

In scenarios where the strain on ratings has more longevity the Directors consider it would be highly probable that a significant proportion of the adverse impact would have been caused by an unforeseen circumstance that could not have been avoided by prudent management action. The Directors would in these circumstances seek an adjustment to allowed turnover and Ofwat would be required to allow this through the regulatory framework.

In making this statement the Directors also considered a report on the analysis undertaken by the Company from a third party with longstanding expertise in regulatory economics and finance.

Following these assessments, and subject to the appropriate performance of Ofwat's statutory duties, the Directors confirm that they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due up to 31 March 2025.

Supplier Payment Policy

The policy in respect of suppliers is to agree the payment terms for transactions in advance and to make payments in accordance with those terms. At 30 June 2018 trade creditors represented approximately 30 days of trade purchases (2017 – 33 days). The Company does not follow any specific external code or standard on payment policy.

Disclosure of Information to Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each Director has taken all the steps that ought to have been taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Re-appointment of Auditor

Following a tender exercise for the audit services Ernst & Young LLP were engaged as auditor of the Company for the current financial year. A resolution for the re-appointment of Ernst & Young LLP for the following year will be put to the forthcoming Board meeting



By order of the Board
Mark Watts – Director
Claverton Down
Bath BA2 7WW

16 October 2018

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE STRATEGIC REPORT, THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors consider the annual report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF WESSEX WATER SERVICES LIMITED

Opinion

We have audited the financial statements of Wessex Water Services Limited for the year ended 30 June 2018 which comprise the Income Statement, Statement of Other Comprehensive Income, Balance Sheet, Statement of Changes in Equity, Cash Flow Statements and the related notes 1 to 30, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is the International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion the financial statements:

- give a true and fair view of the company's affairs as at 30 June 2018 and of its profit for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs(UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 19 and 20 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 19 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' viability statement set out on pages 51-53 in the directors' report about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements
- whether the directors' statement in relation to going concern required under provisions C.1.3 and C.2.2 is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 50 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none">• Revenue recognition• Valuation of bad debt provision• Classification of costs between operating and capital expenditure
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	<ul style="list-style-type: none"> Defined Benefit Pension Liability
Materiality	<ul style="list-style-type: none"> Overall materiality of £7.1m which represents 5% of profit before tax before exceptional items.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Revenue Recognition (Revenue £541.6m, PY comparative £531.6m & Accrued Income £63.7m, PY comparative £56.6m)</p> <p><i>Refer to the Audit Committee Report (page 30); Accounting policies (page 70); and Note 13 of the Financial Statements (page 79)</i></p> <p>Revenue relates to the provision of water and sewerage services. ISAs (UK & Ireland) presume there is a risk of fraud relating to revenue recognition.</p> <p>This risk over revenue recognition arises in relation to the unbilled income accrual from metered water services. This income accrual requires an estimation of the amount of unbilled charges at the period end. This is calculated using system generated information based on previous customer volume usage.</p>	<p>Our procedures include:</p> <ul style="list-style-type: none"> We obtained an understanding of the process for the supply of measured services, meter reading and related billing in order to assess the completeness of adjustments to reflect the accrual or deferral of revenue We tested key controls linked to system generated information and around the estimation process for measured revenue We compared the accrued income to bills raised post year end for a sample of customers, and compared management's history of estimating the accrued income balance to bills raised in the subsequent year to assess the accuracy of the accrued income balance For a selected sample we recalculated the accrued income based on customers' historical usage data We performed analytical procedures by comparing revenue balances for the year against expectation and 	<p>We concluded that the estimation process undertaken by management to calculate the measured income accrual reflects latest operational factors in the key assumptions and results in an acceptable income accrual.</p>

	<p>obtaining support for significant variances</p> <ul style="list-style-type: none"> • We corroborated the key assumptions and estimates made by management in recognising revenue, by obtaining internal and external data on factors that influence demand from customers. • We tested whether contract terms and conditions were met and revenue recognised at the correct time in accordance with IFRS • We tested a sample of transactions to underlying bills • We performed journal testing with increased attention on entries impacting revenue, particularly those raised close to the balance sheet date. 	
<p>Valuation of bad debt provision (£43.3 million, PY comparative £39.0 million)</p> <p><i>Refer to the Audit Committee Report (page 30); Accounting policies (page 70); and included within Note 22 of the Financial Statements (page 92)</i></p> <p>The provision is calculated using a combination of system generated information on historic debt recovery rates and management’s judgement of the future likely recovery rates.</p> <p>There is a risk that the assumptions, used by management in calculating the bad debt provision, may be susceptible to management bias or that data used / calculation may contain errors and the valuation of the provision against trade receivables may be therefore be misstated</p>	<p>Our procedures include:</p> <ul style="list-style-type: none"> • We obtained an understanding of the Company’s process for calculating the bad debt provision as at 30 June 2018, with a specific focus on the assumptions made by management in performing the calculation. • We analysed and assessed the controls testing performed by the service auditors in relation to controls over the integrity of data used by the Company in calculating the provision. We also performed our own substantive testing to ensure the completeness and accuracy of this data. • We challenged the assumptions used by management in determining the amounts provided against the different payment profiles and considered 	<p>We concluded that the method used by the Company to calculate the bad debt provision results in an acceptable valuation of the provision.</p>

	<p>indicators of management bias.</p> <ul style="list-style-type: none"> • We compared assumptions to historic collection rates and confirmed that these were being correctly used in the calculation. • We utilised collection information over the past five years, to determine an alternative assessment of the likely ultimate collection of debts existing at the balance sheet date and compared this to the provision recorded by management • Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. 	
<p>Classification of costs between operating and capital expenditure (Capital expenditure £242.3 million, PY comparative £193.8 million)</p> <p><i>Refer to the Audit Committee Report (page 30); Accounting policies (page 68); and included within Note 10 of the Financial Statements (page 78)</i></p> <p>The magnitude of Wessex Water's capital spend, and the level of subjectivity in allocating costs between operating and capital expenditure result in there being a potential for error in the accounting for fixed assets.</p>	<p>Our procedures include:</p> <ul style="list-style-type: none"> • We tested controls over the approval of the capital budget and the classification of expenditure for individual projects. • We sampled capital expenditure costs in the year and agreed the costs to underlying support, including timesheets, invoices and journal postings. • We made enquiries of project managers for a sample of projects to understand the nature of the work being undertaken, length of the construction period and any key risks which were present on the project. • We challenged management's assumptions used in allocating certain costs between capital and operating expenditure. Specifically this has included assessing the appropriate capitalisation of the following types of costs; 	<p>We concluded that operating and capital expenditure had been correctly accounted for in the financial statements.</p>

	overheads, interest, & infrastructure maintenance.	
<p>Defined benefit pension liability (£125.7 million, PY comparative £195.6 million)</p> <p><i>Refer to the Audit Committee Report (page 30); Accounting policies (page 69); and included within Note 17 of the Financial Statements (page 82)</i></p> <p>Wessex Water Services Limited operates a retirement benefits scheme for its employees which is classified as a defined benefit scheme.</p> <p>The valuation of the defined benefit pension liability requires the use of a number of actuarial and other assumptions in deriving the final values. Given the inherent subjectivity in setting these assumptions there is a risk that the use of inappropriate assumptions may result in a material misstatement.</p>	<ul style="list-style-type: none"> • With the assistance of our EY pension actuarial specialists we assessed the reasonableness of key assumptions, comparing these with external data. • We understood any key events / changes in the pension scheme during the current year. • Evaluated the Company's assessment of the accounting implications of the change in future pension increases • Assessed the Company's financial statement disclosures in relation to the defined benefit pension scheme. 	<p>We concluded that the assumptions selected by the Company to determine the defined benefit pension liability were all within</p>

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the company to be £7.1 million, which is 5% of profit before tax before exceptional items. We believe that profit before tax before exceptional items provides us with an appropriate and generally accepted benchmark for materiality.

In the prior year audit, KPMG adopted a materiality of £7.1 million based on 5% of profit before tax.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the company's overall control environment, our judgement was that performance materiality was 75% of our planning materiality, namely £5.3m. We have set performance materiality at this percentage due to a past history of few misstatements indicating a lower risk of misstatement in the financial statements.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £350,000, which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 1 - 54, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- **Fair, balanced and understandable set out on page 54** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting set out on pages 28-31** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 22** – the parts of the directors' statement relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor (specifically C.1.1, C.2.1 and C.2.3 and C3.1 to C.3.8) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinions on other matters as agreed in our Engagement Letter:

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared with the basis of preparation described therein.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 54, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's directors, as a body, in accordance with our engagement letter dated 6 March 2018. Our audit work has been undertaken so that we might state to the company's directors those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's directors as a body, for our audit work, for this report, or for the opinions we have formed.



Paul Mapleston (Senior Statutory auditor)
For and on behalf of Ernst & Young LLP, Statutory Auditor
Bristol
16 October 2018

Income Statement**For the year ended 30 June 2018**

	<i>Note</i>	2018 £m Before exceptional items	2018 £m Exceptional items	2018 £m Total	2017 £m
Revenue	2	541.6	-	541.6	531.1
Raw materials and consumables used		(35.6)	-	(35.6)	(30.3)
Staff costs		(74.2)	35.9	(38.3)	(62.2)
Depreciation and amortisation		(106.8)	-	(106.8)	(99.5)
Other expenses		(97.7)	-	(97.7)	(105.6)
Total expenses	3	(314.3)	35.9	(278.4)	(297.6)
Operating profit	2	227.3	35.9	263.2	233.5
Financial income	7	0.3	-	0.3	0.9
Financial expenses	7	(86.4)	-	(86.4)	(76.6)
Net financing expense		(86.1)	-	(86.1)	(75.7)
Profit before tax		141.2	35.9	177.1	157.8
Taxation	8	(25.3)	(22.7)	(48.0)	(7.0)
Profit for the year		115.9	13.2	129.1	150.8

As there are no non-controlling interests, the profit for the year is wholly attributable to the owners of the parent company.

Statement of Other Comprehensive Income

For the year ended 30 June 2018

	<i>Note</i>	2018 £m	2017 £m
Profit for the year		129.1	150.8
Other comprehensive income			
<i>Items that will not be reclassified to profit or loss:</i>			
Remeasurements of defined benefit liability	17	32.5	(35.6)
Income tax on items that will not be reclassified to profit or loss	20	(5.5)	4.5
Other comprehensive income/(loss) for the year, net of income tax		27.0	(31.1)
Total comprehensive income for the year		156.1	119.7

As there are no non-controlling interests, the profit for the year is wholly attributable to the owners of the parent company.

Balance Sheet
At 30 June 2018

	Note	2018 £m	2017 £m
Non-current assets			
Property, plant and equipment	10	3,581.2	3,443.0
Investments in subsidiaries	11	-	-
		<u>3,581.2</u>	<u>3,443.0</u>
Current assets			
Inventories	12	5.4	7.0
Trade and other receivables	13	193.3	170.2
Cash and cash equivalents	14	8.7	91.4
		<u>207.4</u>	<u>268.6</u>
Total assets		<u><u>3,788.6</u></u>	<u><u>3,711.6</u></u>
Current liabilities			
Other interest-bearing loans and borrowings	15	(141.4)	(5.5)
Trade and other payables	16	(196.9)	(172.6)
		<u>(338.3)</u>	<u>(178.1)</u>
Non-current liabilities			
Other interest-bearing loans and borrowings	15	(1,880.8)	(2,000.5)
Other payables	16	(0.4)	(0.4)
Employee benefits	17	(126.8)	(196.8)
Deferred income	18	(259.9)	(255.3)
Provisions	19	(0.2)	(0.1)
Deferred tax liabilities	20	(353.6)	(319.9)
		<u>(2,621.7)</u>	<u>(2,773.0)</u>
Total liabilities		<u><u>(2,960.0)</u></u>	<u><u>(2,951.1)</u></u>
Net assets		<u><u>828.6</u></u>	<u><u>760.5</u></u>
Equity			
Share capital	21	-	-
Retained earnings		<u>828.6</u>	<u>760.5</u>
Total equity		<u><u>828.6</u></u>	<u><u>760.5</u></u>

These financial statements were approved by the Board of Directors on 16 October 2018 and were signed on its behalf by:



Mark Watts - Director

Company registered number: 2366648

Statement of Changes in Equity
For the year ended 30 June 2018

	Note	Share capital £m	Retained earnings £m	Total equity £m
Balance at 1 July 2016		-	732.8	732.8
Effect of change in accounting policy		-	-	-
Balance at 1 July 2016 restated		-	732.8	732.8
Total comprehensive income for the year				
Profit for the year		-	150.8	150.8
Other comprehensive income / (loss)		-	(31.1)	(31.1)
Total comprehensive income for the year		-	119.7	119.7
Transactions with owners, recorded directly in equity				
Dividends	9	-	(92.0)	(92.0)
Total contributions by and distributions to owners		-	(92.0)	(92.0)
Balance at 30 June 2017		-	760.5	760.5
Balance at 1 July 2017		-	760.5	760.5
Total comprehensive income for the year				
Profit for the year		-	129.1	129.1
Other comprehensive income		-	27.0	27.0
Total comprehensive income for the year		-	156.1	156.1
Transactions with owners, recorded directly in equity				
Dividends	9	-	(88.0)	(88.0)
Total contributions by and distributions to owners		-	(88.0)	(88.0)
Balance at 30 June 2018		-	828.6	828.6

Included in retained earnings are £557.1m of un-distributable reserves (2017 - £562.4m) created on first time adoption of IFRS when restating infrastructure assets to fair value.

Cash Flow Statement**For the year ended 30 June 2018**

	<i>Note</i>	2018	2017
		£m	£m
Cash flows from operating activities			
Profit for the year		129.1	150.8
<i>Adjustments for:</i>			
Depreciation, amortisation and impairment		106.8	99.5
Financial income		(0.3)	(0.9)
Financial expense		86.4	76.6
Taxation		48.0	7.0
		<u>370.0</u>	<u>333.0</u>
(Increase)/decrease in trade and other receivables		(23.0)	12.2
Decrease/(increase) in inventories		1.6	(1.9)
Increase/(decrease) in trade and other payables		19.6	(9.1)
(Decrease) in provisions and employee benefits		(42.4)	(3.6)
		<u>(44.2)</u>	<u>(2.4)</u>
Tax paid		<u>(22.2)</u>	<u>(23.6)</u>
Net cash from operating activities		<u>303.6</u>	<u>307.0</u>
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment		1.5	7.7
Interest received		0.4	1.0
Acquisition of property, plant and equipment		(242.3)	(193.8)
Proceeds from infrastructure charges and capital contributions		8.4	10.0
Net cash used in investing activities		<u>(232.0)</u>	<u>(175.1)</u>
Cash flows from financing activities			
Proceeds from new loan		-	-
Interest paid		(61.8)	(61.7)
Repayment of borrowings		-	-
Payment of finance lease liabilities		(5.5)	(5.0)
Dividends paid		(87.0)	(92.0)
Net cash used in financing activities		<u>(154.3)</u>	<u>(158.7)</u>
Decrease in cash and cash equivalents		(82.7)	(26.8)
Cash and cash equivalents at 1 July		91.4	118.2
Cash and cash equivalents at 30 June	14	<u>8.7</u>	<u>91.4</u>

Notes to the financial statements

1. Accounting policies

1.1 Basis of preparation

Wessex Water Services Limited (the “Company”) is a private company incorporated, domiciled and registered in England in the UK. The registered number is 2366648 and the registered address is Wessex Water Operations Centre, Claverton Down, Bath, BA2 7WW.

The Company financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU (“Adopted IFRSs”).

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Judgements made by the Directors, in the application of these accounting policies, that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 30.

Group accounts have not been prepared as under section 400 of the Companies Act 2006 the Company and its subsidiary are included in the consolidated financial statements of Wessex Water Ltd (see note 28).

1.2 Measurement convention

The financial statements are prepared on the historical cost basis.

1.3 Going concern

The Directors have considered the financial position of the Company and have concluded that they will be able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least 12 months from the date of approval of these accounts.

1.4 Foreign currency

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined.

1.5 Financial instruments

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and bank deposits. Bank overdrafts that are repayable on demand and form an integral part of the Company’s cash management are included as a component of cash and cash equivalents for the purpose only of the cash flow statement.

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method, less any impairment losses.

Trade receivables

Trade receivables are held at amortised cost less any impairment.

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.6 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leases in which the Company assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Where land and buildings are held under leases the accounting treatment of the land is considered separately from that of the buildings. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and less accumulated impairment losses.

Under IFRIC 18 sewers adopted at nil cost to the Company are included in fixed assets at a fair value, which is cost of construction and depreciated at the same rate as infrastructure assets.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

- Land and buildings 15 to 80 years
- Infrastructure assets 60 to 150 years
- Plant, equipment and vehicles 3 to 30 years
- Office and IT equipment 4 to 15 years

Infrastructure assets comprise 8 components:

Impounding reservoirs 150 years, raw water mains 100 years, treated water mains 100 years, communication pipes 60 years, sewers 125 years, sewage pumping stations 60 years, combined sewer overflows 80 years and sea outfalls 60 years.

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

1.7 Intangible assets

Research and development

Expenditure on research activities is recognised in the income statement as an expense as incurred.

1.8 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

1.9 Impairment excluding inventories and deferred tax assets

Financial assets (including receivables)

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

1.10 Employee benefits

Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Company's net obligation in respect of defined benefit pension plans and other post-employment benefits are calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any plan assets are deducted. The Company determines the net interest on the net defined benefit liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability.

The discount rate is the yield at the reporting date on bonds that have a credit rating of at least AA that have maturity dates approximating the terms of the Company's obligations and that are denominated in the currency in which the benefits are expected to be paid.

Re-measurements arising from defined benefit plans comprise actuarial gains and losses and the return on plan assets. The Company recognises them immediately in other comprehensive income and all other expenses related to defined benefit plans in employee benefit expenses in profit or loss.

When the benefits of a plan are changed, or when a plan is curtailed, the portion of the changed benefit related to past service by employees, or the gain or loss on curtailment, is recognised immediately in profit or loss when the plan amendment or curtailment occurs.

The calculation of the defined benefit obligations is performed by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Company, the recognised asset is limited to the present value of benefits available in the form of any future refunds from the plan or reductions in future contributions and takes into account the adverse effect of any minimum funding requirements.

Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement in the periods during which services are rendered by employees.

The Company's employees are members of the Wessex Water Ltd Group pension scheme. The Company recognises a cost equal to its contribution payable for the period. The assets of the scheme are held separately from those of the Group. The scheme has been closed to new members since 2009.

Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Share-based payment transactions

YTL Power International Berhad operates an equity settled share-based payment scheme for the employees of the group. The fair value of the share-based payment awards is recognised as an expense over the period of the award. The amount recognised is adjusted to reflect the actual number of awards for which service and performance conditions are met at the vesting date. Where YTL Power International Berhad grants rights to its equity instruments to the Company's employees, they are accounted for as a charge to the profit and loss account and an inter-company liability in each accounting period up to the vesting date.

1.11 Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event, that can be reliably measured, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects risks specific to the liability.

1.12 Revenue

Revenue represents income receivable in the ordinary course of business, excluding VAT, for services provided. Revenue is recognised to the extent that it is probable that economic benefits will flow to the Company.

Ongoing supply of water and sewerage services

Under the licenses granted by the Government, three subsidiaries (Wessex Water Services, Water2Business and Albion Water) have the right to supply water and sewerage services and (for WWSL and AWL) an obligation to maintain and develop the network and ensure its continued availability to customers. For metered customers, revenue includes an estimate of the sales value of units consumed between the last meter reading and the end of the period. Where premises are unoccupied or where no services are provided, charges are not raised, and no revenue is recognised. For Unmetered customers revenue is assessed based on the rateable value of the customer's property and the passage of time.

Developer Services

From the perspective of the Company these activities are not separable nor distinct and instead form a bundle of activities necessary to establish an authorised connection from which the network access can be obtained. Also, the Company has an additional obligation under statute to keep the connection in place for all current and future occupiers and facilitate ongoing access to the network for as long as the property requires service provision (which could be in perpetuity). Consequently, revenue from Developer Services will be deferred over the shorter of expected period of service provision or the need to replace the assets at the end of their useful life (typically in the range 60 to 125 years).

1.13 Deferred income

Grants and contributions in respect of specific expenditure on non-infrastructure fixed assets are treated as deferred income and recognised in the profit and loss account over the expected useful economic lives of the related assets.

Grants and contributions relating to infrastructure assets are amortised over the same period as the corresponding components (see Note 1.6).

Under IFRIC 18 sewers adopted at nil cost to the Company are shown in deferred income at a fair value, which is cost of construction, and amortised at the same rate as infrastructure assets are depreciated.

1.14 Bad debt policy

Debt is written off for one of four reasons;

- It is considered or known to be uncollectible
- It is considered uneconomic to collect
- Older debt is written off by agreement with the customer in return for the receipt of monthly payments to pay-off current year debt as part of our "Restart" and "Restart Plus" policies
- Write off is ordered by the County Court. In these cases the Court may set payment at a proportion of the outstanding debt. When this level of payment is reached the Court will instruct that the rest is to be written off.

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.14 *Bad debt policy (continued)*

The policy for calculating the bad debt provision is to analyse the outstanding debt between payment categories and to make provision according to the historical non-collection rate for that payment category. The categories selected are direct debit, instalments, standing orders, DSS, bankruptcy and all other. The profile of provision differs between categories, but for all categories debt that is 4 years old is fully provided.

1.15 Expenses

Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Financing income and expenses

Financing expenses comprise interest payable, finance charges on shares classified as liabilities and finance leases recognised in profit or loss using the effective interest method, unwinding of the discount on provisions, and net foreign exchange losses that are recognised in the income statement (see foreign currency accounting policy). Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that takes a substantial time to be prepared for use, are capitalised as part of the cost of that asset. Financing income comprises interest receivable on funds invested, dividend income, and net foreign exchange gains.

Interest income and interest payable is recognised in profit or loss as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive payments is established. Foreign currency gains and losses are reported on a net basis.

1.16 Taxation

Tax on the profit for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of goodwill; the initial recognition of assets or liabilities that affect neither accounting nor taxable profit other than in a business combination, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

1.17 Dividends

Dividends are proposed by the board and immediately afterwards are authorised by the shareholder and are therefore recognised as a liability in the accounts until paid.

1.18 *Adopted IFRS not yet applied*

The following Adopted IFRSs have been issued but have not been applied in these financial statements:

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.18 Adopted IFRS not yet applied (continued)

IFRS 15 Revenue from Contracts with Customers (Mandatory for years commencing on or after 1 January 2018)

This new Accounting Standard will apply to all contracts with customers except leases, insurance contracts, financial instruments, guarantees and certain non-monetary exchanges. It will supersede and replace:

- IAS 11 & 18 Construction contracts & Revenue
- IFRIC 13 Customer Loyalty Programmes
- IFRIC 15 Agreements for the Construction of Real Estate
- IFRIC 18 Transfers of Assets from Customers
- SIC-31 Revenue – Barter Transactions involving Advertising Services.

The Company has considered the effect of the new standard on each of its revenue streams as follows:

Ongoing supply of water and sewerage services

Under the license granted by the Government the Company has the right to supply water and sewerage services and an obligation to maintain and develop the network and ensure its continued availability to customers. Under IFRS 15: B16 revenue to be recognised is the amount to which the company has a right to receive. For metered customers this is determined by the meter reading, hence no change to the IAS 18 revenue recognition pattern. For unmetered customers, the amount to which the Company has a right to receive is determined by the passage of time during which the customer occupies a property within the Company's licenced region. Again, no change to the IAS 18 revenue recognition pattern.

Developer Services

These are services related to the obligation under statute to allow property developers to establish an authorised connection to the water and/or sewerage network. In obtaining the connection the developer may require the Company to undertake one or more of the following:

- (i) Connections and metering installation in exchange for payment;
- (ii) Requisitions or water mains in exchange for payment (net of income offset); and
- (iii) Adoptions of water mains (in return for payment of the income offset) and wastewater mains.

The developer is also required to pay infrastructure charges being a contribution to network reinforcement.

Period over which performance obligations are satisfied

From the perspective of the Company these activities are not separable nor distinct and instead form a bundle of activities necessary to establish an authorised connection from which the network access can be obtained. Also, the Company has an additional obligation under statute to keep the connection in place for all current and future occupiers and facilitate ongoing access to the network for as long as the property requires service provision (which could be in perpetuity). Consequently, revenue from Developer Services will be deferred over the shorter of expected period of service provision or the need to replace the assets at the end of their useful life (typically in the range 60 to 125 years). Deferral periods are likely to be comparable to those currently used.

Financing Component

Normally under IFRS 15 the transaction price needs to be adjusted if the timing of payments provides the customer or supplier with a significant benefit of financing the transfer of goods or services. We do not consider this to the case for Developer Services as the timing difference does not arise as a result of the provision of finance, but rather comes as a consequence of the nature of the regulatory environment.

Transition approach

As IFRS 15 is expected to be materially consistent with the existing accounting under IFRIC18 / IAS18 the Company proposes to adopt the modified retrospective approach.

- Where a transaction under IFRIC18 / IAS18 had been completed (fully recognised within income statement) the practical expedient on adoption of IFRS 15 allows for no restatement of these transactions.
- Where transactions under IFRIC18 / IAS18 are not fully complete at the transition date and therefore an element of revenue remains deferred on the balance sheet the deferred balance will be reassessed and amended to bring it in line with IFRS15 with a corresponding adjustment to opening reserves.

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.18 Adopted IFRS not yet applied (continued)

IFRS 9 Financial Instruments (Mandatory for years commencing on or after 1 January 2018)

The Company's financial assets and liabilities can all be classified as amortised cost under IFRS 9 and as such there will be no impact from adoption of the new standard. The current methodology for calculation of impairment of trade receivables is expected to closely align with the "expected credit losses" model required by IFRS 9, however the impact is still being determined.

Other Adopted IFRS issued but not yet applied

- Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS12 (Mandatory for years commencing on or after 1 January 2017)
- IFRS 16 Leases (Mandatory for years commencing on or after 1 January 2019)
- Classification and Measurement of Share-Based Payment Transactions – Amendments to IFRS 2
- Annual Improvements to IFRSs – 2015-2017 Cycle

The Company does not currently expect that adoption of these standards will have a significant effect on the results or financial position of the Company but may affect disclosure requirements.

2. Segmental analysis

	2018 £m	2017 £m
<i>Turnover</i>		
Regulated	529.4	522.7
Unregulated	12.2	8.4
	<u>541.6</u>	<u>531.1</u>
<i>Operating profit</i>		
Regulated	263.2	233.5
Unregulated	-	-
	<u>263.2</u>	<u>233.5</u>
<i>Net assets</i>		
Regulated	828.6	760.5
Unregulated	-	-
	<u>828.6</u>	<u>760.5</u>

3. Expenses and auditor's remuneration

Included in profit/loss are the following:

	2018 £m	2017 £m
Impairment loss on other trade receivables	10.7	11.6
Research and development expensed as incurred	0.1	0.2

Notes to the financial statements (continued)**3. Expenses and auditor's remuneration (continued)**

	2018	2017
	£'000	£'000
<i>Auditor's remuneration:</i>		
Audit of these Financial Statements	60	60
Non-statutory audit for Regulatory Accounts	99	99
Taxation compliance services	-	7
Other tax advisory services	-	20
	<u>159</u>	<u>186</u>

4. Exceptional items

Following the latest actuarial valuation of the pension scheme a consultation was held with members to discuss the future funding of the scheme. As part of that consultation the Company, trustees and members agreed that the measurement of inflation for future pension increases would change. From 2020 pension increases for active members will be measured using Consumer Price Index (CPI) rather than Retail Price Index (RPI) which is currently used. The impact of that change is a £32.9m reduction in the IAS19 measurement of retirement benefit obligations, which has been shown in the Income Statement as a reduction in staff costs within total expenses. A further change to the scheme in relation to death in service benefits payable to dependents of members has come into effect this year. The effect of this change is an additional £3.0m reduction, making £35.9m in total. The £35.9m reduction in expenses generated a £6.1m deferred tax charge, a net exceptional credit of £29.8m, which on the balance sheet increases retained earnings, although the increased retained earnings are not distributed as dividends.

During the period, the Company has decided to align its deferred tax accounting in relation to historical industrial buildings with the group methodology with regards to the expected manner of recovery of the assets. This change in estimate has resulted in a £16.6m deferred tax charge in the current period which has been treated as an exceptional item. The adjustment has been included as a tax adjustment for prior years in note 8. This adjustment does not have any cash impact.

5. Staff numbers and costs

The average number of employees (including directors) during the year was as follows:

	Number of employees	
	2018	2017
Average number of employees	<u>2,308</u>	<u>2,151</u>

The aggregate payroll costs of these employees was:

	2018	2017
	£m	£m
Wages and salaries	90.1	81.4
Social security costs	9.5	8.5
Pension costs - normal	13.5	12.1
Pension costs - exceptional	(35.9)	-
	<u>77.2</u>	<u>102.0</u>

Notes to the financial statements (continued)

5. Staff numbers and costs (continued)

These costs were allocated as follows:

Capital schemes	38.9	39.8
Operating expenses - normal	74.2	62.2
Operating expenses - exceptional	(35.9)	-
	<u>77.2</u>	<u>102.0</u>

6. Directors' remuneration

	2018	2017
	£'000	£'000
Total Directors' remuneration including benefits in kind	<u>2,094</u>	<u>2,019</u>
Remuneration of highest paid Director	<u>542</u>	<u>462</u>

Details of Directors' remuneration can be found in the Governance Report. Directors' remuneration is in respect of four Executive Directors, four Non-Executive Directors and five YTL appointed Directors (2017 - four Executive Directors, four Non-Executive Directors and five YTL appointed Directors).

7. Finance income and expense

Recognised in the income statement

	2018	2017
	£m	£m
<i>Finance income</i>		
Interest receivable on short-term bank deposits	<u>0.3</u>	<u>0.9</u>
Total finance income	<u>0.3</u>	<u>0.9</u>
<i>Finance expense</i>		
To fellow subsidiary undertakings	<u>(75.8)</u>	<u>(66.3)</u>
Net interest on net defined benefit pension plan liability	<u>(5.1)</u>	<u>(4.7)</u>
On bank loans and leases	<u>(5.5)</u>	<u>(5.6)</u>
	<u>(86.4)</u>	<u>(76.6)</u>
Net interest payable	<u>(86.1)</u>	<u>(75.7)</u>

In accordance with IAS 23 borrowing costs of £2.5m (2017 - £1.7m) associated with the funding of eligible capital projects have been capitalised at an interest rate of 4.1% (2017 - 4.3%).

Notes to the financial statements (continued)

8. Taxation

Recognised in the income statement

	2018	2017
	£m	£m
<i>Current tax expense</i>		
Current year	21.0	26.6
Adjustments for prior years	(1.2)	(0.7)
Current tax expense	19.8	25.9
<i>Deferred tax expense</i>		
Origination and reversal of temporary differences	11.6	4.3
Reduction in tax rate	-	(20.7)
Adjustments for prior years	16.6	(2.5)
Deferred tax charge/(credit)	28.2	(18.9)
Total Tax Expense	48.0	7.0

Taxation recognised in other comprehensive income

	2018	2017
	£m	£m
Remeasurements of defined benefit liability	(5.5)	6.1
Change in tax rate	-	(1.6)
Tax (debit)/credit	(5.5)	4.5

Reconciliation of effective tax rate

	2018	2017
	£m	£m
Profit for the year	129.1	150.8
Total tax expense / (credit)	48.0	7.0
Profit excluding taxation:	177.1	157.8
Tax using the UK corporation tax rate of 19% (2017 - 19.75%)	33.6	31.2
Reduction of tax rate on deferred tax balances	(1.3)	(21.4)
Non-deductible expenses	0.6	1.0
(Over) provided in prior years	(1.3)	(3.2)
Exceptional item (see Note 4)	16.6	-
Group relief for nil consideration	-	(0.6)
Other	(0.2)	-
Total tax expense	48.0	7.0

Notes to the financial statements (continued)

8. Taxation (continued)

A reduction to the UK Corporation Tax rate from 19% to 18% (effective from 1 April 2020) was substantively enacted in October 2015. A further reduction to the UK Corporation tax rate to 17% (effective from 1 April 2020) was substantively enacted in September 2016. Consequently, the deferred tax balances at the balance sheet date have been remeasured at that date.

9. Dividends

The dividend policy is to declare dividends consistent with the company's performance and prudent management of the economic risk of the business.

	2018	2017
	£m	£m
Interim dividends for the current year	67.0	71.0
Final dividend for the current year	21.0	21.0
	88.0	92.0

Notes to the financial statements (continued)

10. Property, plant and equipment

	Land & buildings £m	Infra-structure assets £m	Plant, equipment & vehicles £m	Office & IT equipment £m	Company total £m
Cost					
Balance at 1 July 2016	863.1	2,002.4	1,601.4	26.8	4,493.7
Additions	6.0	66.4	112.9	4.2	189.5
Disposals	(0.3)	(1.5)	(11.4)	(0.1)	(13.3)
Balance at 30 June 2017	868.8	2,067.3	1,702.9	30.9	4,669.9
Balance at 1 July 2017	868.8	2,067.3	1,702.9	30.9	4,669.9
Additions	4.0	72.9	167.4	5.4	249.7
Disposals	(1.3)	(1.9)	(12.3)	-	(15.5)
Balance at 30 June 2018	871.5	2,138.3	1,858.0	36.3	4,904.1
Depreciation and impairment					
Balance at 1 July 2016	(270.9)	(49.8)	(795.0)	(15.1)	(1,130.8)
Depreciation charge for the year	(14.1)	(18.0)	(70.3)	(2.8)	(105.2)
Disposals	0.2	-	8.9	-	9.1
Balance at 30 June 2017	(284.8)	(67.8)	(856.4)	(17.9)	(1,226.9)
Balance at 1 July 2017	(284.8)	(67.8)	(856.4)	(17.9)	(1,226.9)
Depreciation charge for the year	(14.0)	(18.8)	(72.0)	(2.9)	(107.7)
Disposals	0.7	-	11.0	-	11.7
Balance at 30 June 2018	(298.1)	(86.6)	(917.4)	(20.8)	(1,322.9)
Net Book Value					
At 1 July 2016	592.2	1,952.6	806.4	11.7	3,362.9
At 30 June 2017	584.0	1,999.5	846.5	13.0	3,443.0
At 30 June 2018	573.4	2,051.7	940.6	15.5	3,581.2

Infrastructure assets comprise a network of systems of mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines, sea outfalls and infrastructure investigations and studies.

Included in infrastructure assets at 1 July 2014 is £703.5m fair value adjustment on first time adoption of IFRS.

There is no impairment loss recognised in these financial statements.

Notes to the financial statements (continued)

10. Property, plant and equipment (continued)

At 30 June 2018 the net book value of leased plant and machinery was £7.0m (2017 - £9.9m). The leased equipment secures lease obligations (see note 15).

Assets under construction included in the values above were £334.0m (2017 - £243.7m).

Cumulative borrowing costs capitalised and included above were £9.2m (2017 - £6.7m).

Included in freehold land and buildings above is an amount of £16.1m (2017 - £13.2m) in respect of land which is not depreciated.

11. Investments in subsidiaries

The Company has an investment of £13,000 (2017 – £13,000) in 100% of the ordinary share capital of a subsidiary company Wessex Water Services Finance Plc.

12. Inventories

	2018 £m	2017 £m
Raw materials and consumables	3.0	3.0
Work in progress	2.4	4.0
	<u>5.4</u>	<u>7.0</u>

Raw materials, consumables and work in progress recognised as cost of sales in the year amounted to £3.4m (2017 - £3.4m). There was no write-down of inventories to net realisable value in either year.

13. Trade and other receivables

	2018 £m	2017 £m
Trade receivables	62.9	56.8
Owed by parent company	24.9	23.7
Owed by fellow subsidiary companies	28.2	22.4
Owed by other group companies	0.4	0.6
Prepayments	6.1	5.2
Accrued income	63.7	56.6
Other debtors	7.1	4.9
	<u>193.3</u>	<u>170.2</u>

Notes to the financial statements (continued)

14. Cash and cash equivalents

	2018 £m	2017 £m
Short-term bank deposits	6.5	90.0
Cash at bank	2.2	1.4
	<u>8.7</u>	<u>91.4</u>

15. Other interest-bearing loans and borrowings

	2018 £m	2017 £m
Non-current liabilities		
Bank loans	275.0	415.0
Finance lease liabilities	-	1.4
Inter-company loans	<u>1,605.8</u>	<u>1,584.1</u>
	<u>1,880.8</u>	<u>2,000.5</u>
Current liabilities		
Bank overdraft	-	-
Short-term bank borrowing	140.0	-
Current portion of finance lease liabilities	<u>1.4</u>	<u>5.5</u>
	<u>141.4</u>	<u>5.5</u>

Terms and debt repayment schedule

	Currency	Nominal interest rate	Year of maturity	Face value 2018 £m	Carrying amount 2018 £m	Face value 2017 £m	Carrying amount 2017 £m
Bank loans	Sterling		2018- 2024	275.0	275.0	415.0	415.0
<i>Inter-company loans</i>							
Bond	Sterling	5.375%	2028	199.0	198.6	198.8	198.4
Bond	Sterling	5.75%	2033	347.3	346.2	347.1	346.1
Bond	Sterling	4.00%	2021	199.1	199.1	198.9	198.9
Bond	Sterling	4.00%	2021	103.0	103.0	103.9	103.9
Index Linked Bond	Sterling	3.52%	2023	77.7	77.7	75.5	75.5
Index Linked Bond	Sterling	2.186%	2039	65.0	65.0	62.9	62.9
Index Linked Bond	Sterling	1.75%	2046	104.5	104.5	101.6	101.6
Index Linked Bond	Sterling	1.75%	2051	104.5	104.5	101.6	101.6
Index Linked Bond	Sterling	1.369%	2057	104.5	104.5	101.6	101.6
Index Linked Bond	Sterling	1.374%	2057	104.5	104.5	101.6	101.6
Index Linked Bond	Sterling	1.489%	2058	66.1	66.1	64.0	64.0
Index Linked Bond	Sterling	1.495%	2058	66.1	66.1	64.0	64.0
Index Linked Bond	Sterling	1.499%	2058	66.0	66.0	64.0	64.0
				<u>1,882.3</u>	<u>1,880.8</u>	<u>2,000.5</u>	<u>1,999.1</u>

Notes to the financial statements (continued)

15. Other interest-bearing loans and borrowings (continued)

Finance lease liabilities

Finance lease liabilities are payable as follows:

	Minimum lease payments 2018 £m	Interest 2018 £m	Principal 2018 £m	Minimum lease payments 2017 £m	Interest 2017 £m	Principal 2017 £m
Less than one year	1.5	(0.1)	1.4	5.8	(0.3)	5.5
Between one and five years	-	-	-	1.5	(0.1)	1.4
	1.5	(0.1)	1.4	7.3	(0.4)	6.9

Changes in liabilities arising from financing activities

	1st July 2017 £m	Cash flows £m	Reclassi- fied on disposal £m	Foreign exchange £m	Changes in fair value £m	New leases £m	Other £m	30th June 2018 £m
Current interest-bearing loans and borrowings (excluding items listed below)	-	-	-	-	-	-	140.0	140.0
Current obligations under finance leases and hire purchase contracts	5.5	(5.5)	-	-	-	-	1.4	1.4
Non-current interest- bearing loans and borrowings (excluding items listed below)	1,999.1	-	-	-	-	-	(118.3)	1,880.8
Non-current obligations under finance leases and hire purchase contracts	1.4	-	-	-	-	-	(1.4)	-
Total liabilities from financing activities	2,006.0	(5.5)	-	-	-	-	21.7	2,022.2

The 'Other' column includes the effect of reclassification of the non-current portion of interest-bearing loans and borrowings, including obligations under finance leases and hire purchase contracts to current due to the passage of time and the effect of accrued but not yet paid interest on interest-bearing loans and borrowings. The Company classifies interest paid as cash flows from financing activities.

Notes to the financial statements (continued)**16. Trade and other payables**

	2018 £m	2017 £m
Current		
Amounts payable to subsidiary company	31.2	31.0
Amounts payable to other group companies	0.6	0.6
Trade payables	19.7	15.1
Dividend	22.0	21.0
Other creditors	3.5	2.6
Corporation tax	14.0	16.4
Taxation and social security	2.8	2.2
Deferred income	48.7	36.1
Accrued expenses	54.4	47.6
	<u>196.9</u>	<u>172.6</u>
Non-current		
Other payables	0.4	0.4
	<u>197.3</u>	<u>173.0</u>

17. Employee benefits**Pension plans**

	2018 £m	2017 £m
Fair value of scheme assets	613.8	593.3
Present value of defined benefit obligations	<u>(739.5)</u>	<u>(788.9)</u>
Net (liability) for defined benefit obligations	(125.7)	(195.6)
Unfunded and compensatory added years pension	<u>(1.1)</u>	<u>(1.2)</u>
Total employee benefits	<u>(126.8)</u>	<u>(196.8)</u>

The Company sponsors a funded defined benefit pension plan for qualifying UK employees. The plan is administered by a separate board of Trustees which is legally separate from the Company. The Trustees are composed of representatives of both the employer and employees. The Trustees are required by law to act in the interest of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day to day administration of the benefits.

Under the plan, employees are entitled to annual pensions on retirement using an accrual rate, final pensionable salary and service. Benefits are also payable on death and following other events such as withdrawing from active service. No other post-retirement benefits are provided to these employees.

Liabilities for an unfunded arrangement and a compensatory payment for added years' service are held outside the defined benefit scheme. The Company also operates a defined contribution section within the main pension scheme.

a. Profile of the Scheme

The defined benefit obligation includes benefits for current employees, former employees and current pensioners. Broadly, about 34% of the liabilities are attributable to current employees, 17% to former employees and 49% to current pensioners. The Scheme duration is an indicator of the weighted-average time until benefit payments are made. For the Scheme as a whole, the duration is around 20 years reflecting the approximate split of the defined benefit obligation between current employees (duration of 25 years), deferred members (duration of 25 years) and current pensioners (duration of 15 years).

Notes to the financial statements (continued)

17. Employee benefits (continued)

b. Funding requirements

UK legislation requires that pension schemes are funded prudently. The last funding valuation of the Scheme was carried out by a qualified actuary as at 30 September 2016 and showed a deficit of £160.9 million. The Company is paying deficit contributions of:

- £7.60M by 31 March 2017;
- £11.00M by 31 March 2018;
- £11.38M by 31 March 2019;
- £11.77M by 31 March 2020;
- £12.04M by 31 March 2021;
- £12.32M by 31 March 2022;
- £12.60M by 31 March 2023;
- £12.90M by 31 March 2024;
- £13.19M by 31 March 2025;
- £13.50M by 31 March 2026;

which, along with investment returns from return-seeking assets, is expected to make good this shortfall by 31 March 2026.

The next funding valuation is due no later than 30 September 2019 at which progress towards full funding will be reviewed.

The Company also pays contributions of 21.7% of pensionable salaries from April 2018 (18.2% prior to this date) in respect of current accrual and non-investment related expenses, with active members paying a further 7.3% of pensionable salaries on average. A contribution of £11.38m is expected to be paid by the Company during the year ending on 30 June 2019.

c. Risks associated with the Scheme

Asset volatility - The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The Scheme holds a significant proportion of growth assets (equities, diversified growth fund and global absolute return fund) which, though expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term. The allocation to growth assets is monitored to ensure it remains appropriate given the Scheme's long-term objectives.

Changes in bond yields - A decrease in corporate bond yields will increase the value placed on the Scheme's liabilities for accounting purposes, although this will be partially offset by an increase in the value of the Scheme's bond holdings.

Inflation risk - The majority of the Scheme's benefit obligations are linked to inflation and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The majority of the assets are either unaffected by or only loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit.

Life expectancy - The majority of the Scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities.

The Trustees insure certain benefits payable on death before retirement.

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension ("GMP"). The UK Government intends to implement legislation which could result in an increase in the value of GMP for males. This would increase the defined benefit obligation of the plan. At this stage, it is not possible to quantify the impact of this change.

Notes to the financial statements (continued)**17. Employee benefits (continued)****d. Reporting at 30 June 2018**

The results of the latest funding valuation at 30 September 2016 have been adjusted to the balance sheet date taking account of experience over the period since 30 September 2016, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the defined benefit obligation, and the related current service cost, were measured using the Projected Unit Cost Method.

The principal assumptions used to calculate the liabilities under IAS 19 are set out below. The major assumptions used by the actuary were:

	30.06.18	30.06.17
Rate of increase in salaries – year 1	3.2%	3.2%
Rate of increase in salaries – years 2 (2016 years 2 to 3)	1.8%	3.2%
Rate of increase in salaries – long term	1.8%	3.7%
Rate of increase in pensions in payment	2.2% or 3.1%	2.2% or 3.1%
Rate of increase in pensions in payment - reduced level members	2.2%	2.2%
Discount rate	2.8%	2.6%
Inflation assumption – RPI	3.2%	3.2%
Inflation assumption – CPI	2.2%	2.2%

The mortality assumptions are based upon the recent actual mortality experience of Scheme members and allow for expected future improvements in mortality rates. The assumptions are that a member currently aged 60 will live, on average, for a further 27.1 years (2017 – 27.0 years) if they are male, and for a further 29.2 years (2017 – 29.1 years) if they are female. For a member who retires in 2038 at age 60 the assumptions are that they will live, on average, for a further 28.3 years (2017 – 28.2 years) after retirement if they are male, and a further 30.4 years (2017 – 30.4 years) after retirement if they are female.

The mortality table adopted is based upon 95% of standard tables S2P(M/F)A adjusted to allow for individual years of birth. Future improvements are assumed to be in line with the CMI 2016 core projection, with a long-term improvement rate of 1.0% p.a. for all members.

Sensitivity analysis:

The key assumptions used for IAS 19 are: discount rate, inflation and mortality. If different assumptions are used, this could have a material effect on the results disclosed. The sensitivity of the results to these assumptions are set out below. For the purposes of these sensitivities it has been assumed that the change in the discount rate and inflation has no impact on the value of Scheme assets.

- A reduction in the discount rate of 0.1% from 2.8% to 2.7% would increase the scheme liabilities by £14.1m from £739.5m to £753.6m, increasing the scheme deficit to £139.8m
- An increase in the inflation assumption of 0.1% (from 2.2% to 2.3% for CPI and 3.2% to 3.3% for RPI) would increase the scheme liabilities by £13.6m from £739.5m to £753.1m, increasing the scheme deficit to £139.3m
- An increase in life expectancy of 1 year would increase the scheme liabilities by £26.6m from £739.5m to £766.1m, increasing the scheme deficit to £152.3m.

Notes to the financial statements (continued)**17. Employee benefits (continued)**

e. The value of the assets as follows:

	2018	2017
	£m	£m
Equities	254.5	260.8
Property	38.8	35.8
Government Bonds	171.7	144.1
Corporate Bonds	135.4	127.5
Other	13.4	25.1
	<u>613.8</u>	<u>593.3</u>

f. The amounts recognised in comprehensive income are set out below:

	2018	2017
	£m	£m
Operating cost – service cost		
Current service cost	12.3	12.0
Administration expenses	0.6	0.6
Past service cost	(35.9)	0.1
Financing cost		
Interest on net benefit liability	5.1	4.7
Pension expense recognised in profit and loss	(17.9)	17.4
Re-measurements in Other Comprehensive Income (OCI)		
Return on plan assets in excess of that recognised in net interest	(9.5)	(41.9)
Actuarial (gains)/losses due to changes in financial assumptions	(29.7)	100.7
Actuarial gains due to changes in demographic assumptions	-	(6.5)
Actuarial (gains)/losses due to liability experience	6.7	(16.7)
Pension amount recognised in OCI	(32.5)	35.6
Total amount recognised in profit and loss and OCI	<u>(50.4)</u>	<u>53.0</u>

g. Changes to the present value of the defined benefit obligations during the year:

	2018	2017
	£m	£m
Opening defined benefit obligation	788.9	702.8
Current service cost	12.3	12.0
Interest expense on defined benefit obligation	20.7	20.5
Contributions by scheme participants	0.2	0.2
Actuarial gains due to changes in demographic assumptions	-	(6.5)
Actuarial (gains)/losses due to changes in financial assumptions	(29.7)	100.7
Actuarial (gains)/losses due to liability experience	6.7	(16.7)
Net benefits paid out	(23.7)	(24.2)
Past service cost (including curtailments)	(35.9)	0.1
Closing defined benefit obligation	<u>739.5</u>	<u>788.9</u>

Notes to the financial statements (continued)**17. Employee benefits (continued)**

h. Changes to the fair value of scheme assets during the year:

	2018 £m	2017 £m
Opening fair value of scheme assets	593.3	544.1
Interest income on scheme assets	15.6	15.8
Re-measurement gains on scheme assets	9.5	41.9
Contributions by employer	19.5	16.1
Contributions by scheme participants	0.2	0.2
Net benefits paid out	(23.7)	(24.2)
Administration costs incurred	(0.6)	(0.6)
Closing fair value of scheme assets	<u>613.8</u>	<u>593.3</u>

i. Additional analysis:

	2018 £m	2017 £m
Actual return on scheme assets		
Interest income on scheme assets	15.6	15.8
Re-measurement gains on scheme assets	9.5	41.9
Actual return on scheme assets	<u>25.1</u>	<u>57.7</u>
Analysis of amounts recognised in Other Comprehensive Income		
Total re-measurement gains/(losses)	<u>32.5</u>	<u>(35.6)</u>
Total gain/(loss)	<u>32.5</u>	<u>(35.6)</u>

History of asset values, defined benefit obligations, deficit in the scheme and experience gains and losses

	30.06.18 £m	30.06.17 £m	30.06.16 £m	30.06.15 £m	30.06.14 £m
Fair value of scheme assets	613.8	593.3	544.1	516.1	467.7
Defined benefit obligation	(739.5)	(788.9)	(702.8)	(638.2)	(566.5)
Deficit in the scheme	<u>(125.7)</u>	<u>(195.6)</u>	<u>(158.7)</u>	<u>(122.1)</u>	<u>(98.8)</u>
Experience gains on scheme assets	9.5	41.9	12.0		
Experience gains on scheme liabilities	(6.7)	16.7	6.4		

Defined contribution plans

The Company also operates a defined contribution pension plan.

The total expense relating to this plan in the current year was £4.1m (2017 - £3.1m).

Notes to the financial statements (continued)

17. Employee benefits (continued)

Share-based payments

YTL Power International Berhad (a subsidiary of the ultimate parent company YTL Corporation Berhad) operates share option schemes under which options are granted to employees of the Company. The current scheme the “YTL Power International Berhad Employees Share Option Scheme 2011” first issued share options to employees on 1 June 2012. The terms of the 2011 scheme are specified under the YTL Power International Berhad Employees Share Option Scheme 2011 (2011 UK part) known as the “2011 UK Plan”.

The majority of options have been issued under terms approved by the Inland Revenue, the “Approved” scheme, but some have been issued to senior employees under an “Unapproved” scheme. The options are for ordinary shares of YTL Power International Berhad of Malaysian Ringgit RM0.50 each.

2011 UK Plan

The exercise price and fair value of the share options are as follows:

Granted – Ordinary shares of RM0.50 each	Vesting date	Expiry date	Exercise price RM	Fair value RM
01/06/2012 Unapproved	01/06/2015	31/03/2021	1.41	0.22
01/06/2012 Approved	01/06/2015	31/03/2021	1.65	0.16

Under IFRS 2 equity settled share-based payments are measured at the fair value at the date of the grant, and the fair value is expensed on a straight-line basis over the vesting period. There was no charge recognised in the profit and loss account for IFRS 2 as the share options have passed their vesting date. The key assumptions were as follows:

Scheme	Weighted avg. share price at grant RM	Expected volatility %	Expected option life years	Risk free rate %	Dividend yield %
01/06/2012 Unapproved	1.63	21.2	3	3.14	5.6
01/06/2012 Approved	1.63	21.2	3	3.14	5.6

The following options were outstanding at 30 June 2017 and 30 June 2018:

Granted – Ordinary shares of RM0.50 each	Outstanding at 30 June 2017	Granted	Forfeited	Exercised	Outstanding at 30 June 2018
01/06/2012 Unapproved	7,843,000	-	(356,000)	-	7,487,000
01/06/2012 Approved	37,434,000	-	(835,000)	-	36,599,000
TOTAL	45,277,000	-	(1,191,000)	-	44,086,000

The share price at 30 June 2018 was RM1.03 or £0.19.

Notes to the financial statements (continued)

18. Deferred income

	Above ground grants £m	Below ground grants £m	Sewer adoptions £m	Total £m
Balance at 1 July 2016	9.0	160.8	81.4	251.2
Received during the year	0.3	9.7	(3.7)	6.3
Amortisation	(0.4)	(1.2)	(0.6)	(2.2)
Balance at 30 June 2017	8.9	169.3	77.1	255.3
Balance at 1 July 2017	8.9	169.3	77.1	255.3
Received during the year	-	7.9	-	7.9
Amortisation	(0.5)	(2.0)	(0.8)	(3.3)
Balance at 30 June 2018	8.4	175.2	76.3	259.9

Sewer adoptions received in the prior year include a reduction for the revision of previous estimates.

19. Provisions

	Restructuring costs £m	Total £m
Balance at 1 July 2017	0.1	0.1
Provisions made during the year	0.4	0.4
Provisions used during the year	(0.3)	(0.3)
Balance at 30 June 2018	0.2	0.2
Non-current	-	-
Current	0.2	0.2
Balance at 30 June 2018	0.2	0.2

The restructuring provision is in respect of a reorganisation announced before the prior year-end, delivering efficiencies in the third year of the AMP 6 price review period.

Notes to the financial statements (continued)

20. Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Liabilities		Assets		Net	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
Property, plant and equipment	399.1	377.1	(23.9)	(23.7)	375.2	353.4
Employee benefits	-	-	(21.6)	(33.4)	(21.6)	(33.4)
Provisions	-	-	-	(0.1)	-	(0.1)
Tax (assets) / liabilities	399.1	377.1	(45.5)	(57.2)	353.6	319.9
Net of tax liabilities/(assets)	(45.5)	(57.2)	45.5	57.2	-	-
Net tax liabilities	353.6	319.9	-	-	353.6	319.9

Movement in deferred tax during the year

	1 July 2017 £m	Recognised in income £m	Recognised in equity £m	30 June 2018 £m
Property, plant and equipment	353.4	21.9	-	375.3
Employee benefits	(33.4)	6.2	5.5	(21.7)
Provisions	(0.1)	0.1	-	-
	319.9	28.2	5.5	353.6

Movement in deferred tax during the prior year

	1 July 2016 £m	Recognised in income £m	Recognised in equity £m	30 June 2017 £m
Property, plant and equipment	372.2	(18.8)	-	353.4
Employee benefits	(28.8)	(0.1)	(4.5)	(33.4)
Provisions	(0.1)	-	-	(0.1)
	343.3	(18.9)	(4.5)	319.9

Notes to the financial statements (continued)**21. Capital and reserves****Share capital**

	2018	2017
	£	£
Issued at 1 April	1	1
Issued at 31 March	1	1
<i>Allotted, called up and fully paid</i>		
Ordinary shares of £1each	1	1
	1	1
Shares classified as liabilities	-	-
Shares classified in shareholders' funds	1	1
	1	1

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

22. Financial instruments**(a) Fair values of financial instruments**

Fair value is the amount at which a financial instrument could be exchanged in an arms-length transaction between informed and willing parties, other than a forced or liquidation sale. The fair value of short term and floating rate borrowings approximate to book value. The fair value of long term fixed rate borrowings has been calculated using market values or discounted cash flow techniques.

The IFRS 13 fair value hierarchy is a categorisation relating to the extent that the fair value can be determined by reference to comparable market values. The hierarchy ranges from level 1 where instruments are quoted on an active market through to level 3 where the assumptions used to derive fair value do not have comparable market data.

The fair values of long term fixed rate inter-company loans are classified as level 1 in the IFRS 13 fair value hierarchy and have a carrying value of £1,605.8m and a fair value of £2,160.2m. Bank loans and overdrafts are classified as level 2 and have a carrying value and fair value of £415.0m. All other loans and leases are classified as level 2 and have a carrying and fair value of £1.4m.

It is the Company's policy to recognise all the transfers into the levels and transfers out of the levels at the date of the event or change in circumstances that caused the transfer. No liabilities are classified as level 3.

Notes to the financial statements (continued)**22 Financial instruments (continued)**

The fair values of all financial assets and financial liabilities by class together with their carrying amounts shown in the balance sheet are as follows:

	Carrying amount	Fair value	Level 1	Level 2	Carrying amount	Fair value	Level 1	Level 2
	2018	2018	2018	2018	2017	2017	2017	2017
	£m	£m	£m	£m	£m	£m	£m	£m
Loans and receivables								
Cash and cash equivalents (note 14)	(8.7)	(8.7)	-	(8.7)	(91.4)	(91.4)	-	(91.4)
Total financial assets	(8.7)	(8.7)	-	(8.7)	(91.4)	(91.4)	-	(91.4)
Bank overdraft (note 15)	-	-	-	-	-	-	-	-
Other interest-bearing loans and borrowings (note 15 current)	141.4	141.4	-	141.4	5.5	5.5	-	5.5
Other financial liabilities measured at amortised cost (note 15 non-current)	1,880.8	2,435.2	2,160.2	275.0	2,000.5	2,657.3	2,240.9	416.4
Total financial liabilities	2,022.2	2,576.6	2,160.2	416.4	2,006.0	2,662.8	2,240.9	421.9
Total financial instruments	2,013.5	2,567.9	2,160.2	407.7	1,914.6	2,571.4	2,240.9	330.5

(b) Credit risk**Financial risk management**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's receivables from customers and investment securities.

Cash and cash equivalents are short term deposits with counterparties that have a credit rating of A1+/P1 or A1/P1, and hence there is no exposure to credit risk for these values.

	2018	2017
	£m	£m
Cash and cash equivalents	8.7	91.4
	<u>8.7</u>	<u>91.4</u>

The concentration of credit risk for trade receivables (see note 13) at the balance sheet date by geographic region was:

South West England	62.9	56.8
	<u>62.9</u>	<u>56.8</u>

Notes to the financial statements (continued)

22 Financial instruments (continued)

Trade receivables are from domestic and business customers. No individual customer or industrial sector has a material balance outstanding at either year end.

The aging of trade receivables at the balance sheet date was:

	Gross 2018 £m	Impairment 2018 £m	Gross 2017 £m	Impairment 2017 £m
Less than 1 year	40.5	(5.0)	37.0	(5.5)
1 to 2 years	19.4	(6.1)	18.5	(6.3)
2 to 3 years	15.2	(6.3)	15.0	(6.5)
3 to 4 years	13.0	(7.8)	12.0	(7.4)
More than 4 years	18.1	(18.1)	13.3	(13.3)
	106.2	(43.3)	95.8	(39.0)

The movement in the provision for bad debts in respect of trade receivables during the year was as follows:

	2018 £m	2017 £m
Balance at 1 July	(39.0)	(44.7)
Written off	6.4	17.3
Charge to profit and loss	(10.7)	(11.6)
Balance at 30 June	(43.3)	(39.0)

The bad debt policy is shown in the accounting policies (note 1).

(c) Cash flow hedges

The Company does not have any cash flow hedges (2017 – none).

(d) Liquidity risk

Financial risk management

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due.

The Company is a regulated utility with a five-year settlement with the industry regulator, which allows it to plan to a certain degree of accuracy the financial obligations in the medium term. The Company has also secured long-term funding through bonds issued by its subsidiary company. This means that the need to obtain additional finance has been spread over future years and is not considered onerous in any one regulatory period.

Notes to the financial statements (continued)

22 Financial instruments (continued)

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the effect of netting agreements:

	Carrying amount	Contractual cash flows	Year 1	Years 2 to 5	Over 5 years
	2018	2018	2018	2018	2018
	£m	£m	£m	£m	£m
Non-derivative financial instruments					
Finance lease liabilities	1.4	1.5	1.5	-	-
Secured bank loans	415.0	438.3	144.8	90.2	203.3
Inter-company loans	1,605.8	4,785.4	57.4	523.0	4,205.0
Total financial instruments	2,022.2	5,225.2	203.7	613.2	4,408.3

	Carrying amount	Contractual cash flows	Year 1	Years 2 to 5	Over 5 years
	2017	2017	2017	2017	2017
	£m	£m	£m	£m	£m
Non-derivative financial instruments					
Finance lease liabilities	6.9	7.3	5.8	1.5	-
Secured bank loans	415.0	441.2	4.8	230.3	206.1
Inter-company loans	1,584.1	3,854.0	56.7	530.3	3,267.0
Total financial instruments	2,006.0	4,302.5	67.3	762.1	3,473.1

(e) Market risk

There is no exposure to equity or foreign currency risk, the interest rate risk is shown below.

Interest rate risk

At the year end the interest rate profile of the Company's interest-bearing financial instruments was:

	2018	2017
	£m	£m
Fixed rate instruments	946.9	947.3
Floating rate instruments	316.4	321.9
Index linked instruments	758.9	736.8
	2,022.2	2,006.0

The Company policy is to keep a significant proportion of total financial instruments in each of the three categories.

Sensitivity

The floating rate instruments are sensitive to interest rate movements. If there was a 1% increase in interest rates on those floating rate instruments at the balance sheet date, there would be an additional interest charge to the income statement of £3.2m.

Notes to the financial statements (continued)**23 Capital Management**

For the purpose of the Company's capital management, capital includes issued capital, share premium and all other equity reserves attributable to the equity holders. The primary objective of the Company's capital management is to maximise the shareholder value.

The Company manages its capital structure and makes adjustments in light of changes in economic conditions and the requirements of the financial covenants. To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. The Company monitors capital using a gearing ratio, which is net debt divided Regulatory Capital Value (RCV). The Company's policy is to keep the gearing ratio below 70%. The Company includes within net debt interest bearing loans and borrowings, less cash and short-term deposits, excluding discontinued operations.

	2018	2017
	£m	£m
Cash at bank	(2.2)	(1.4)
Short term deposits	(6.5)	(90.0)
Bank Loans	415.0	415.0
Finance leases	1.4	6.9
Bonds	1,605.8	1,584.1
Total Net Debt	2,013.5	1,914.6
RCV at 30 June	3,147.5	2,985.4
Gearing	64%	64%

The RCV for each Regulated Water and Sewerage Company is published by Ofwat here:

<https://www.ofwat.gov.uk/publication/regulatory-capital-values-2018/>

In order to achieve this overall objective, the Company's capital management, among other things, aims to ensure that it meets financial covenants attached to the interest-bearing loans and borrowings that define capital structure requirements. Breaches in meeting the financial covenants would permit the bank to immediately call loans and borrowings. There have been no breaches of the financial covenants of any interest-bearing loans and borrowing in the current period.

No changes were made in the objectives, policies or processes for managing capital during the years ended 30 June 2018 and 2017.

24 Operating Leases

Non-cancellable operating lease rentals payable by the Company were £0.1m (2017 – nil). Future leasing commitments are as follows:

Term	Commitment
	£m
Less than one year	0.1
One to two years	0.1
two to five years	-
more than five years	0.6
Total	0.8

During the year £2.8m was recognised as an expense in the income statement in respect of operating leases (2017 - £2.3m) and £1.0m (2017 - £1.0m) was recognised as rental income by the Company.

Notes to the financial statements (continued)

25 Commitments

Capital expenditure contracted but not provided at 30 June 2018 was £81.8m (2017 - £65.6m).

The Company has guaranteed Bonds of £1,605.8m (2017 - £1,584.1m) issued by its wholly owned subsidiary company Wessex Water Services Finance Plc.

26 Contingencies

There are no material contingent liabilities at 30 June 2018 for which provision has not been made in these accounts.

27 Significant transactions with related parties

There were no transactions with key management personnel. Directors' emoluments have been disclosed in the Governance Report.

There have been no transactions with the holding companies described in note 28.

All other transactions with related parties and balances at the year-end are summarised in the following table:

	2018 £m	2017 £m
Sales of goods and services:		
Fellow subsidiaries	114.5	35.7
Other group companies	0.7	-
Immediate holding company	3.0	1.3
Purchase of goods and services:		
Fellow subsidiaries	-	-
Interest expense:		
Subsidiaries	78.3	68.0
Year-end balances owing by:		
Fellow subsidiaries	28.2	22.4
Other group companies	0.4	0.6
Immediate holding company	24.9	23.7
Year-end balances owing to:		
Subsidiaries	31.2	31.0
Other group companies	0.6	0.6

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made on terms equivalent to those that prevail in arm's length transactions.

28 Ultimate parent company and parent company of larger group

The smallest group into which the financial statements of the Company are consolidated is that headed by Wessex Water Ltd, a company incorporated in England whose registered address is Wessex Water Operations Centre, Claverton Down, Bath, BA2 7WW.

The pre-penultimate, penultimate and ultimate holding companies are YTL Power International Berhad, YTL Corporation Berhad and Yeoh Tiong Lay & Sons Holdings Sdn Bhd respectively, all registered in Malaysia.

The largest group in which the results of the Company are consolidated is that headed by YTL Corporation Berhad incorporated in Malaysia. The consolidated financial statements of these groups are available to the public and can be obtained from Yeoh Tiong Lay Plaza, 55 Jalan Bukit Bintang, 55100 Kuala Lumpur, Malaysia.

Notes to the financial statements (continued)

29 Subsequent events

There are no subsequent events requiring disclosure in these financial statements. The final dividend for the year was declared in June 2018 and paid in July 2018.

30 Accounting estimates and judgements

In preparing the financial statements and applying the accounting policies, the Company is required to make reasonable estimates and judgements based on the available information, the most significant of which are;

a) Bad debt provision

The methodology behind the provision is based upon historic debt recovery rates and the method of payment of the debt. This is combined with judgement as to likely future recovery rates to determine a percentage of debt to be provided according to the age and payment type.

b) Classification of capital expenditure

Due to the high value of capital expenditure the judgements made on the classification of expenses as operating or capital, and within capital between maintenance and enhancement, are key to the preparation of the accounts. The Company follows both accounting standards and guidelines issued by Ofwat in making these judgements.

c) Revenue recognition

The unbilled income accrual from metered water services requires an estimation of the amount of unbilled charges at the period end. This is calculated using system generated information based on previous customer volume usage.

d) Asset lives

Assets recorded in the Company's fixed asset register are depreciated systematically using asset lives assigned to the classification of the asset into a number of standard asset types. These asset lives are subject to review based on historical performance, new technologies or new areas of capital investment.

e) Defined benefit pension scheme deficit

In recognising the deficit on the balance sheet there are a number of assumptions concerning inflation, rate of increase of salaries and pensions, mortality rates and interest rates that can have a significant effect on the deficit recorded. These assumptions are discussed with independent qualified actuaries and disclosed in note 19 to the financial statements.